FISCAL YEAR 1983 HUD AUTHORIZATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT'S FISCAL YEAR 1983 LEGISLATIVE PROGRAM AND THE FUTURE DIRECTION OF FEDERAL SUPPORT OF COMMUNITY DEVELOPMENT AND HOUSING

MARCH 30, APRIL 14 AND 15, 1982

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FISCAL YEAR 1983 HUD AUTHORIZATIONS

TUESDAY, MARCH 30, 1982

U.S. Senate,
Subcommittee on Housing and Urban Affairs,
Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

The subcommittee met at 9:30 a.m., in room 5302, Dirksen Senate Office Building, Senator Richard Lugar (chairman of the subcommittee) presiding.

Present: Senators Lugar, Garn, D'Amato, Proxmire, and Riegle.

OPENING STATEMENT OF SENATOR LUGAR

Senator Lugar. This hearing of the Housing Subcommittee is called to order. The Chair is grateful for the presence of the chairman of the Banking Committee, Senator Garn. We are very pleased this morning to begin our annual reauthorization process for the Department of Housing and Urban Development, and I'm especially pleased to have Secretary Samuel R. Pierce, Jr., before us to present the administration's proposals for fiscal year 1983.

The subcommittee is anxious and willing to consider new approaches to serving the housing needs of low-income persons. Last year's efforts to streamline and control costs of the existing set of housing programs, while progressive and important, still did not abate the tremendous cost of these programs and the staggering fact they have already obligated the Federal Government to a mortgage of more than quarter of a trillion dollars, nor do they really address the primary problem of poor people and housing affordability.

Therefore, the subcommittee embarks on consideration of new approaches to housing assistance for the poor which will allow us to work in harmony with economic goals and policies established by Congress and the administration while continuing to help people without sufficient personal resources who find safe and healthful shelter hard to come by.

Some will argue that housing absorbed a disproportionate share of budget cuts in fiscal year 1982 and should be spared further reductions. Yet, in fiscal year 1982, we still added more than $17 billion to the long-term debt of the Federal Government. I would argue that in this current climate of budget deficits approaching $100 billion, we must look further and can make additional reductions while still helping additional low-income families find and obtain shelter they need.

The proposals that Secretary Pierce brings today would begin that search. These proposals shift the emphasis of Federal assistance from buildings to people. They also underscore the fact that this Nation already has a valuable stock of existing housing which should be preserved and recycled through rehabilitation.

Together, these proposals hold promise of sheltering more people than we can construct new living units for, and clearly offer us a path away from the ever-growing per unit cost of new construction and the long-term debt such construction entails.

These may not be the only solutions and do not preclude us from considering other imaginative proposals which future witnesses or members of the committee may suggest, but they do demonstrate that with creative intention, a willingness to be flexible in program design and execution, and a conviction the Government does not have to be the builder of last resort. We can still meet our obligations with far less impact on the deficit.

Secretary Pierce will begin this discussion today and following the Secretary will be two representatives of small and large public housing authorities, respectively, to discuss the very difficult problems confronting the managers of our extensive public housing inventory.

This subcommittee is committed to finding responsible solutions to the operation problems which have nagged the public housing program since the midsixties. We will continue the hearings after the Easter recess with 2 days for public witnesses to address the broad range of topics raised by the need to reauthorize HUD programs. Those hearings are scheduled for April 14 and 15. Included in this schedule will be Federal flood insurance and the crime and riot reinsurance program.

Once again, I wish to thank the Secretary, Mr. Quinn, and Mr. Spence who will be testifying later on for joining us for these important discussions.

Before I ask the Secretary to testify, I'd like to ask other members of the subcommittee for opening remarks. Senator Garn.

Senator **Garn**. Mr. Chairman, I have no opening statement. I'd like to welcome Secretary Pierce here and commend you for the fine job you have done as chairman of this subcommittee in a number of areas with persistence and hard work and in some difficult times and I certainly, as chairman of the committee, appreciate the way you have handled this responsibility.

Senator **Lugar**. Thank you, Senator Garn.

Senator D'Amato.

Senator **D'Amato**. Thank you, Mr. Chairman. I would like to ask that my remarks be placed in the record as if read in their entirety.

Senator **Lugar**. So ordered.

[Statement follows:]

OPENING STATEMENT OF SENATOR D'AMATO

Senator **D'Amato**. One of the directives of the President's Commission on Housing is to devise alternatives to high-cost new construction. In the past the Federal Government has literally thrown money into new construction in an effort to assure decent and affordable housing for our citizens. Now that it is no longer possible to attempt to solve problems with excessive injections from the

Federal Treasury, we must begin to solve our housing crisis, especially in the inner cities, with innovative strategies.

Many of our cities, both large and small, have an abundance of housing which is in the process of deteriorating. If this creeping decay is not arrested and reversed, it will take extraordinary cost to replace it in the future. Currently it costs the Federal Government $60,000 per unit to use section 8 substantial rehabilitation or new construction funding. This cost can be cut substantially, to between $9,000 and $15,000 if buildings can be rehabilitated with the tenant remaining as an occupant. If we can provide incentives to invest in multifamily housing, and to arrest deterioration—before the tenants have vacated the units, low-cost rehabilitation is not only possible it is economical in financial and in human terms. The results of such a program will be to extend the useful life of existing housing at affordable rents with little or no tenant displacement.

Shortly, I intend to introduce the Multifamily Housing Rehabilitation Act of 1982 which will address the need to preserve our existing housing for low- and moderate-income neighborhoods. My bill will encourage private investment, eliminate Government regulation wherever possible, leverage private investment, and expand present laws to include moderate rehabilitation.

I am very encouraged that the administration's proposal and my legislation share the same goals—to preserve our existing housing stock. Placing more emphasis on rehabilitation is not only financially sound, but absolutely essential. I certainly look forward to working with HUD on this very important area of housing.

It should also be a goal of coinsurance to encourage underwriters to originate loans in high-risk neighborhoods, so that the private sector becomes involved in areas that previously were almost the exclusive province of HUD. Further, I would suggest that HUD permit private lenders to reinsure their top loss by using either a private mortgage insurance company or a State mortgage insurance agency.

One of the problems that currently stifles the moderate rehabilitation program is the ceiling on FHA/223(f) insurance of $3,000 per unit. Waivers are available but as recent history has shown in the targeted area preservation program [TAP] the process is lengthy and time consuming and inextricably bound up in redtape. Unless the ceiling is changed drastically upward moderate rehabilitation will not be viable.

My experiences with the TAP program has led me to believe that the most efficient way for the Government to assist in rehabilitating multifamily housing is to allow the private sector to do the work it does best: Underwriting and actual rehabilitation. The Government can be helpful in supplying the grants, insurance, and possibly tax-exempt financing. Together HUD and the private sector must work together to save our neighborhoods and maintain decent, safe, and affordable housing in our cities and towns.

I welcome our Secretary and commend him for undertaking a very difficult task in light of the cutbacks and I think that he is maximizing the resources that have been placed at his disposal and I see some very innovative and creative thinking to deal with the deteriorated housing in some of our neighborhoods, to stop that blight, that deterioration, before it becomes more acute and there is no treatment necessary, and I am very encouraged by the manner in which I see the Secretary's program moving.

Senator LUGAR. Thank you, Senator D'Amato.

Secretary Pierce, we welcome your testimony.

STATEMENT OF SAMUEL R. PIERCE, JR., SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary PIERCE. Thank you very much, sir.

Mr. Chairman, I would like to make some opening comments and then submit a more detailed statement for the record.

Senator LUGAR. It will be included in our record.

Secretary PIERCE. Mr. Chairman, members of the committee, I am pleased to appear before this committee to discuss HUD's fiscal year 1983 legislative program and the future direction of Federal support of community development and housing.

The Department's 1983 program reflects a marked departure from the past and proposes a major redirection in the approach of the Federal Government to housing and urban development.

We believe significant changes must be made in the way housing programs operate and the ways they are funded if the Federal Government is to continue to meet the objective of assisting those who most need such support. Our program therefore proposes fundamental shifts in the policies followed by this Department for the past two decades. My statement for the record describes our program in some detail. Before summarizing our major proposals, I would like to put into context the approach we are taking as it relates to the economic goals of this administration.

A primary goal of the administration is to bring inflation and the high interest rates of the past several years under control. Unless we end this inflationary spiral and place our Government on a sound economic footing, we face a disastrous future. Double digit inflation and high interest rates have taken their toll on all of us. In the housing industry this has been reflected dramatically in soaring housing costs which have priced most Americans out of the home buying market and has caused severe hardships for those whose livelihood depends on a healthy shelter industry.

BURDEN ON LOW-INCOME FAMILIES

The harshest burden has fallen on those low-income families for whom achievement of the goal of decent, safe, and sanitary dwellings has become increasingly difficult. The administration's program for economic recovery has only begun and it will take time for the Nation to realize its benefits. As inflation and interest rates are brought under control, the housing industry should prosper as it has in the past when interest rates were lower and more stable. Restoration of a healthy economic environment will improve the ability of all groups in our society to find decent housing at affordable prices and rents.

The Department's fiscal year 1983 program and $3.5 billion budget level for the community development block grant program reflects the importance the administration places on economically and socially viable communities. The Department is not proposing legislative amendments to the community development block grant program this year. However, we have made substantial progress in implementing the 1981 amendments, especially in the small cities programs as described in my statement for the record.

We are proposing to continue the urban development action grant program at the same funding level as in 1982. Our recently completed evaluation concluded that UDAG is substantially fulfilling its congressional mandate and that for the most part UDAG projects are living up to the private investment and job creation that was originally anticipated.

We are also proposing to expand the urban homesteading approach to demonstrate how it can be applied to HUD-held multifamily properties. Our community development initiative this year includes two major proposals—the administration's enterprise zones plan announced by the President last week, and a new rental rehabilitation program to help preserve and upgrade the Nation's rental housing stock.

Both of these initiatives will involve State, local, and private sector participation in upgrading and revitalizing our cities and neighborhoods. Last year the Department worked closely with the Congress to address the high cost of housing programs and reduce the inequities and inefficiencies that had developed over the years. We have made progress in those areas.

This year the administration is proposing significant changes in the direction of subsidized housing programs. Perhaps the most important aspect of our fiscal year 1983 assisted housing program is the shift away from long-term subsidies for new construction and our emphasis on the use of existing housing stock. We are proposing to cease offering new commitments for the very expensive section 8 new construction substantial rehabilitation program and the public housing development program.

In their place, we will rely more heavily on less expensive and more flexible kinds of subsidies to assist lower income families. The only exception to this general strategy is section 202 for the elderly and handicapped. Simply stated, our present production programs are too costly, provide too large a subsidy for too few people, and are, at best, an indirect way of addressing the basic housing problem confronting lower income families.

In most localities, the problem is not a lack of adequate housing resources but, rather, a lack of adequate family income. To achieve our proposed change of program direction from costly, long-term commitments, we are proposing a new component, a modified certificate under the section 8 existing housing assistance program. We expect the certificate to become the cornerstone of HUD's future assistance to the truly needy.

HOUSING ALLOWANCE PROGRAM

Our proposal is based upon experience from the 10-year experimental housing allowance program and the successful section 8 existing program. The modified certificate program is designed to provide flexibility for participating families and to encourage households to shop for less expensive units and negotiate for lower rents.

It also will provide families with increased opportunities to improve their housing by allowing them to choose from a wider range of units. In public housing, as in section 8, we are proposing not to offer commitments for new construction. Instead, we will focus on improving the physical condition and upgrading the management and operation of existing public housing projects to assure their long-term viability.

The Department's fiscal year 1983 program anticipates continuation of the phase-in of rent increases for subsidized housing tenants. This will be coupled with an administration initiative to take food stamps into account in determining tenant income and an amendment for an overall 20-percent cap on rent increases attributable to certain legislative changes.

Even with the proposed changes in this area, the rent burden for tenants who receive Federal assistance will continue to be significantly lower than for low-income families who do not receive such assistance.

Our legislative proposals for FHA are directed to three primary objectives. We propose, first, to direct FHA's single family programs to homebuyers unserved or underserved by the private sector. Second, to modernize FHA programs to meet the changing requirements of the marketplace; and third, to increase housing affordability and achieve cost savings at HUD.

We think serving first-time and innercity homebuyers is an appropriate role for FHA and we are proposing means of facilitating credit to these users, including limited authority to insure various alternative mortgage instruments.

GNMA pioneered the development of the secondary market for mortgage financing through the mortgage backed securities program. We propose continuation of this program at a level of $38.4 billion. The level proposed this year reflects a more realistic assessment of the amount of credit required to meet program demand in the current economic environment.

We are not proposing any further funding for the GNMA tandem mortgage purchase program. This program has turned out to be much more expensive than originally contemplated and the effects often have not been focused on the truly needy.

The program changes and new directions being undertaken by this Department are important and necessary steps in orienting Federal resources that no longer can be regarded as unlimited. We believe these scarce resources should be directed, in the words of the Housing Commission, "toward people rather than toward structures."

For the past year, this administration has worked diligently to develop a more rational and economically viable approach to the problem of providing shelter for the Nation's poor and to attack the serious long-term budgetary problems created by the section 8 program. We believe these proposals are cost effective and needed and, above all, are fair and equitable. I urge this committee and the Congress to consider them carefully.

Thank you very much, sir, and I will submit for the record my more thorough presentation.

Senator LUGAR. Without objection, that presentation as well as the excellent summation you've given will be part of our record.

[Complete statement of Secretary Pierce follows:]

STATEMENT OF SAMUEL R. PIERCE, JR., SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

I am pleased to appear before this Committee to discuss HUD's fiscal year 1983 Legislative program and the future direction of Federal support of community development and housing.

The Department's 1983 program reflects a marked departure from the past and proposes a major redirection in the approach of the Federal Government to housing and urban development.

We believe significant changes must be made in the way housing programs operate and in the ways they are funded if the Federal Government is to continue to meet the objective of assisting those who most need such support. Our program, therefore, proposes fundamental shifts in the policies followed by this Department for the past two decades.

My statement will describe our program in some detail. First, however, I would like to put into context the approach we are taking as it relates to the major economic goals of this Administration. A primary goal of the Administration is to bring inflation and the high interest rates of the past several years under control. Unless we end this inflationary spiral and place our Government on a sound economic footing, we face a disastrous future.

The program proposed by the President and supported by the Congress—a substantial reduction in the growth of Federal spending, a 25 percent cut in the Federal tax burden during the next three years, the prudent elimination of excessive regulation, and development of a monetary policy geared to stabilize and revitalize the economy—is absolutely necessary if we are to succeed.

Double-digit inflation and high interest rates have taken their toll on all of us. In the housing industry, this has been reflected dramatically in soaring housing costs which have priced most Americans out of the homebuying market, and has caused severe hardships for many homebuilders, real estate agents, construction workers, and other Americans whose livelihood depends on a healthy shelter industry. The harshest burden has fallen on those low-income families for whom achievement of the goal of decent, safe and sanitary dwellings has become increasingly difficult.

The Administration's program for economic recovery has only begun, and it will take time for the Nation to realize its benefits. As inflation and interest rates are brought under control, the housing industry should prosper as it has in the past when interest rates were lower and more stable. Restoration of a healthy economic environment will improve the ability of all groups in our society to find decent housing at affordable prices and rents.

COMMUNITY DEVELOPMENT

The Department's fiscal year 1983 program and $3.5 billion budget level for the Community Development Block Grant Program reflects the importance the Administration places on economically and socially viable communities. Although the Department is not proposing legislative amendments to the Community Development Block Grant program this year, I would like to report to you on the progress we have made thus far in implementing the 1981 amendments, especially in the small cities program.

The response of States across the country to the opportunity to determine how to distribute over $1 billion in community development funds has been gratifying. We anticipate that up to 36 States will exercise their option under the legislation to administer the program in Fiscal Year 1982, and another 10 to 12 will assume responsibility in Fiscal Year 1983.

The scope of the consultation and hearing process that has been carried out thus far has exceeded our expectations. Many States have formed committees or task forces, consisting of elected local officials and community development practitioners, to advise on the most appropriate means of implementing state-run community development programs.

The result has been the development of a wide variety of State programs. Some programs are emphasizing housing, others focus on public facilities to deal with the shortage of adequate water and sewer facilities, particularly in small rural communities and counties, and many are emphasizing economic development to create or retain jobs for residents of these areas.

We are confident these State programs will reflect the objectives of the 1981 amendments and will result in the use of Community Development funds in a manner consistent with State and local needs.

We have conducted design and implementation forums in 25 States and will be conducting over the next few months a series of training sessions to acquaint States with the Federal requirements for which they will assume responsibility. Also, Section 107 Technical Assistance is available to those States expressing an interest in assuming responsibility for the program in either fiscal years 1982 or 1983.

The Department will issue revised regulations for the HUD-Managed Small Cities Program within the next few weeks. Because the statute no longer requires an application or a Housing Assistance Plan, we will be able to implement a one-step application process, instead of the two-step process employed in the past for this program. The selection process will provide small cities considerably more flexibility in designing their programs.

URBAN DEVELOPMENT ACTION GRANTS

The fiscal year 1983 Budget proposes to continue the Urban Development Action Grant (UDAG) Program at $440 million, the same funding level as in 1982. Last year I announced that an evaluation of the UDAG program would be carried out by our Office of Policy Development and Research. The evaluation team conducted an intensive examination of 80 Action Grant projects in 70 cities. This first evaluation concluded that UDAG is substantially fulfilling its Congressional mandate, and that, for the most part, UDAG projects are living up to the private investment and job creation that was originally anticipated. The study enabled us to make several changes that will improve the program's performance in promoting economic development in distressed cities and urban counties.

New Action Grant regulations incorporating the legislative provisions enacted last year were published in the Federal Register on February 23, 1982 with an effective date of March 31. Consistent with the amended statute, the UDAG planning process has been streamlined substantially to reduce time and paperwork burdens on applicants. We have incorporated the new provision that the UDAG subsidy be the least amount required for the project to proceed, and we have strengthened language to insure that the UDAG grant is not used as a substitute for other available non-Federal funds.

The regulations stipulate increased emphasis on economic recovery and improve our ability to respond to local priorities by eliminating the requirement that HUD fund a reasonable balance among commercial, industrial, and neighborhood projects. Those projects best implementing economic recovery goals—leveraging private investment and providing jobs and taxes in distressed cities and urban counties—will receive priority.

ENTERPRISE ZONES

The Administration is proposing several new initiatives this year to help revitalize communities. A major initiative is our plan for Enterprise Zones, an experimental free-market program for improving and developing depressed areas. This proposal will permit States and localities to apply to the Federal Government for designation as Enterprise Zones and is consistent with the Administration's objective of strengthening the flexibility of State and local governments.

The purpose of the program is twofold: to create jobs in depressed urban areas and rural towns, particularly jobs for disadvantaged workers, and to redevelop and revitalize the geographic zone area.

The Enterprise Zone concept relies on market processes—rather than Federal subsidies and central planning—by providing tax relief and reducing regulations at the Federal, State and local levels. It is also designed to encourage improvement in local public services and involve private, local and neighborhood organizations in the program.

Under the proposed legislation, HUD would be authorized to approve the designation of an area as an enterprise zone on the application of the State and local governments, if the area meets eligibility criteria based on poverty, unemployment, and other measures of distress. Up to 25 zones per year, for three years, could be so designated, on a competitive basis.

Although there will be no Federal outlays for the program, the Treasury Department estimates that $310 million in tax revenues will be foregone for 25 enterprise zones in the first year of operation. Assuming the program is successful in stimulating economic development and employing unemployed resources, this revenue loss should be significantly offset by the generation of new revenues and by reduced government expenditures due to the employment of individuals formerly receiving government aid. The cost of the program should, therefore, be even less.

Enterprise Zones offer great promise for improving the quality of life in distressed communities, and I hope Congress will give this proposal expeditious and favorable consideration.

RENTAL REHABILITATION PROGRAM

The Administration is also proposing a new rental rehabilitation program to help preserve and upgrade the Nation's rental housing stock. The new program will replace the Section 312 Rehabilitation loan and Section 8 Moderate Rehabilitation programs.

The program will provide grant assistance of $150 million to local governments and States to support the rehabilitation of approximately 30,000 units. The grants will be used to subsidize the cost of rehabilitating properties for rental at competitive market rates.

This rehabilitation initiative will be linked to the new Modified Section 8 Certificate program. Under our proposal, 30,000 Modified Section 8 Certificates will be made available to states and localities carrying out rental rehabilitation programs. These certificates will be provided to eligible tenants residing in units to be rehabilitated under the initiative. The tenants will have the option of remaining in the units after rehabilitation or using the assistance provided by the certificates to reside in other dwellings of their choice.

Those certificates available as a result of tenants ineligible for assistance residing in the rehabilitated units could be used to assist other eligible families in the locality. The program is designed to encourage participating governments to insure that the rehabilitated units be affordable at market rates to certificate holders.

We believe this program will be far more cost effective than previous rehabilitation efforts and will result in increased private sector participation in upgrading valuable existing housing assets.

URBAN HOMESTEADING

The Department also is proposing $12 million in 1983 to continue and expand the urban homesteading approach to housing and neighborhood revitalization. In addition to the homesteading of single family properties in the HUD inventory, a demonstration program is proposed for use of HUD-held multifamily properties for urban homesteading, specifically "condo-steading" and "coop-steading." We intend to evaluate the effectiveness of this demonstration in revitalizing distressed neighborhoods and in providing homeownership opportunities for more people.

HOUSING ASSISTANCE PROGRAMS

Last year, the Department worked closely with the Congress to address the high costs of housing programs and reduce the inequities and inefficiencies that had developed over the years. We have made progress in these areas.

During the past year, we have provided cost containment and modest design requirements for the Section 8 and Section 202 programs, and we have developed regulations for increasing the percentage of tenant income paid for rent on a five-year phased-in basis. These efforts will continue.

This year the Administration is proposing significant changes in the direction of subsidized housing programs. Perhaps the most important aspect of our 1983 assisted housing program is the shift away from long-term subsidies for new construction, and our emphasis on the use of existing housing stock.

Eliminating costly new production.—The Administration is proposing to cease offering new commitments for the very expensive Section 8 new construction/substantial rehabilitation program and the public housing development program, In their place, we will rely more heavily on less expensive and more flexible kinds of susbsidies to assist lower-income families. The only exception to this general strategy is the Section 202 program for the elderly and handicapped.

Simply stated, our present production programs are too costly, provide too large a subsidy for too few people, and are at best an indirect way of addressing the basic housing problem confronting lower-income families. In most localities, the problem is not a lack of adequate housing resources, but rather, a lack of adequate family income.

In recent years, tenant rent subsidies paid to the developers of new Section 8 projects have been rising at twice the rate of increase in construction costs. For example, subsidized housing outlays grew from $2.9 billion in 1978 to $5.7 billion in 1981, which reflects an annual growth rate of 24 percent. By the end of fiscal year 1981, commitments for future housing outlays totals $236 billion. Annual subsidies in some areas range as high as $17,000 per unit, with up to a 30-year commitment to provide this level of subsidy. Public housing is also expensive, with development costs averaging $63,000 per unit. It is clear that we can no longer afford the luxury of providing rental assistance in the same way it has been furnished in recent years.

The Department has commitments to subsidize some 300,00 Section 8 and Public Housing units that have not begun construction. Many of these projects are not financially viable and are not making progress toward the construction phase. Where this is the case, we will take steps to cancel the commitments and use the deobligated funds to conduct our proposed program.

At the same time, I want to make it clear that we intend to honor subsidy commitments and will continue to process those projects that are able to proceed to construction. As a result, we expect the Administration's program to increase the number of subsidized households from 3.3 million to 3.8 million by the end of fiscal year 1985.

Emphasizing use of existing stock: The modified section 8 existing housing assistance program.—To achieve our proposed change of program direction from costly, long-term commitments, we are proposing a new component—a "Modified Certificate"—under the Section 8 Existing Housing Assistance program. We expect the certificate to become the cornerstone of HUD's future assistance to the truly needy. Our proposal is based upon experience from the 10-year Experimental Housing Allowance Program and the successful Section 8 Existing program.

The modified certificate program will be structured in much the same way as the current Section 8 Existing certificate program with payments continuing to go directly to the owner. However, instead of having rent "capped" by an established "Fair Market Rent," as in the current Section 8 Existing housing program, tenants will recieve a set subsidy, based on their income and the relative housing costs in the area, to apply toward rent in units of their choice.

If the subsidy recipients find "bargains" meeting housing quality standards, they can retain the savings. If they want to select more expensive units, they must pay the cost difference themselves.

The modified certificate program is designed to provide flexibility for participating families, and to encourage households to shop for less expensive units and negotiate for lower rents. It also will provide families with increased opportunities to improve their housing by allowing them to choose from a wider range of units.

For Fiscal Year 1983, our budget request anticipates 106,615 Modified Certificates. The bulk of these would assist conversions from the regular Section 8 Existing program as current commitments with Public Housing Agencies expire. Funding will also be available for assisted families when owners of Section 8 New Construction projects do not renew their subsidy contracts, when Public Housing projects are sold or demolished, or when formerly-subsidized HUD-owned projects are sold.

Housing for the elderly.—The Administration recognizes the special needs involved in providing housing for the elderly and handicapped—needs which often must be met through new construction—and proposes continuation of the Section 202 direct loan program.

The fiscal year 1983 budget level of $453 million in loan authority will enable us to make commitments for about 10,000 new units for the elderly or handicapped. While this represents a reduced level from the 17,000 unit reservations we expect to make during fiscal year 1982, we anticipate no slackening in the pace in which 202 units are completed and made available for occupancy. Due to loan commitments made this year and in prior years, we expect to see a total of 20,000 new units made available for occupancy in fiscal year 1983, and nearly 100,000 new units made available over the next three years.

In order to achieve maximum benefit from the loan authority already available, the Department is taking steps to cancel projects which have been in the pipeline for a long period of time and which are not making any progress toward construction.

In addition, we are implementing reforms this year that will eliminate unnecessary amenities in these projects, permit competitive bidding in construction, and subject the program to the same cost controls as other Federally-assisted housing programs. As a result, and in spite of continuing inflation, we expect to achieve a decrease in the average cost of a completed unit from $48,300 to $42,300 in 1983.

Emphasizing modernization of public housing stock.—Until recently, the basic approach to upgrading public housing was to finance piecemeal physical improvements rather than one-time substantial rehabilitation of a project. This approach was adequate for most projects requiring only selected physical improvements, but was inadequate for those projects with several physical deficiencies.

We propose to fund the Comprehensive Improvement Assistance, or Modernization, Program in fiscal years 1982 and 1983 at a level of $1.8 billion for each year. This represents an increase or $100 million over the 1981 level of $1.7 billion actually used. Under this program, we are providing financial assistance to public housing agencies (PHA's) to improve the physical condition and upgrade the management and operation of existing public housing projects to assure the long-term viability of the projects.

To assist in financing this program we propose to offer local authorities the option of cancelling outstanding reservations for construction of new Public Housing projects and to use a portion of the balance for the modernization of existing projects. This will provide housing authorities with increased flexibility in dealing with local needs.

In conjunction with the Comprehensive Improvement Assistance Program, PHA's will be evaluating their projects to determine whether they can be made available for low-income tenants on a cost-effective basis, or whether it would be more efficient to sell or demolish them and provide the tenants with Modified Section 8 Certificates to secure other units. The request for authorization to sell or demolish public housing units must originate with the PHA's.

Public housing operating subsidies.—For fiscal year 1983 we propose $1,075 million to fund public housing operating subsidy requirements. This estimate reflects adjustments in operating subsidies based on proposed procedural and regulatory changes affecting tenant rent payments and PHA operation, more efficient PHA management, increased support by State and local governments, and anticipated savings from improvements in energy efficiency.

Included in the adjustments is the impact of increasing the maximum allowable rent contribution to 27 percent of income in 1983 for existing public housing tenants and 30 percent of income for new public housing tenants.

During the past several months the Department has been examining alternative methods of distributing operating subsidy funds, as directed by the Congress in the Omnibus Budget Reconciliation Act of 1981. We have nearly completed the report and expect to be able to submit it to the Committee in the near future.

Adjustments in tenant rent contributions.—The Department's fiscal year 1983 program anticipates continuation of the phase-in of rent increases for subsidized housing tenants. This will be coupled with an Administration initiative to take food stamps into account in determining tenant income.

We also propose that the discretion given the Secretary to implement last year's rent increases be available to assure the gradual phase-in of any increases in tenant contribution resulting from implementation of the modified certificate program.

In addition, we are proposing an overall 20 percent cap on annual rent increases attributable to certain legislative changes. Specifically, the cap would apply to increases attributable to the 1981 rent increase amendments, to the determination of a family's contribution under the modified certificate program, and to any change in Federal law dealing with what benefits can be counted as income for housing assistance purposes, e.g., food stamps.

It should be noted that the rent burden for tenants who receive Federal assistance will continue to be significantly lower than for low-income families who do not receive such assistance. Very low-income renters not assisted by HUD programs are currently paying an average of 50 percent of their income for housing. Even under the proposed amendments, HUD-assisted tenants will, in general, be much better off than unassisted households.

Indian housing.—We plan to move the approximately 14,000 units now in the Indian housing pipeline to construction and occupancy. We expect these units to be completed at a rate of about 4,000 units per year over the next three years.

High development costs, excessive Federal requirements, and current management problems make it imperative to develop a more effective, less costly approach before additional new funds are made available. For this reason, the Department is not requesting new authority for Indian Housing in Fiscal Year 1983.

The Office of Management and Budget established a Task Force in the fall of 1981, to review Indian housing and related programs. HUD is a member of this Task Force which is now in the process of completing its report.

In the interim, we are emphasizing improvement in management practices by Indian Housing Authorities. Financially troubled Indian Housing Authorities have been asked to develop and implement Management Improvement Plans, and HUD Indian Field Office staff continue to be available to assist Indian communities in formulating appropriate actions to overcome financial and management problems.

NEW DIRECTIONS FOR FHA

Our legislative proposals for FHA are directed to three primary objectives. We propose, first, to direct FHA's single-family programs to homebuyers unserved or underserved by the private sector; second, to modernize FHA programs to meet the changing requirements of the marketplace; and third, to increase housing affordability and achieve cost savings at HUD.

Negotiated interest rates.—A change, long overdue, is the elimination of regulated mortgage interest rates for FHA programs. Under our proposal for negotiated rates, the mortgage interest rate, the commitment fee, and any discount points will be negotiated and agreed upon between the borrower and the lender. This change will allow interest rates to "float" with the market, and will in most instances obviate the need for excessive discount points.

Alternative mortgage instruments.—We are requesting limited authority to insure various alternative mortgage instruments to keep pace with a rapidly changing mortgage market.

Based on the success of our Graduated Payment Mortgage (GPM) program for homebuyers, we are proposing a more limited GPM authority for use with multifamily rental projects.

We are also proposing to offer Adjustable Rate Mortgages (ARM's). This would allow FHA homebuyers a choice between a fixed-rate mortgage with an interest rate continuing an inflation premium, or an adjustable rate mortgage wherein the borrower shares with the lender in any inflation risk.

The Department's proposed Shared Appreciation Mortgage (SAM) is intended for use with both single-family and multi-family housing. Like the GPM currently offered by FHA for single-family mortgagors, the SAM makes possible more readily available mortgage credit—and possibly lower initial monthly payments—in exchange for a sharing of any appreciation realized at loan termination or sale of the property.

Mortgage insurance premiums.—Our proposal to require the "upfront" payment of the FHA mortgage insurance premium (MIP) represents a substantial improvement in the Department's collection of premium payments—without burdening the mortgagor. The change will ensure that sufficient revenues are available to meet early year insurance claims. In addition, the change will lower the costs of administering the system for both FHA and participating lenders.

In order to relieve the mortgagor of the burden of having to make a larger cash downpayment at loan origination, we are proposing an amendment so that the "upfront" premium would not increase the mortgagor's downpayment. Under our proposal, the mortgagor would be able to amortize the lump-sum premium along with the full mortgage amount.

Other FHA initiatives.—We are also proposing other initiatives that will enable us to improve our efficiency and usefulness. These include a proposed amendment to Section 234(c) to eliminate the existing constraint on insuring units in non-FHA insured condomium projects less than a year old, and amendments to Section 207 and 234(c)(2) to remove language requiring HUD regulation of insured project rents and rates of return, and substitute discretionary authority in the Secretary. The latter amendments will permit the Department to deregulate rent levels in all unsubsidized, insured projects.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA)

Mortgage-backed securities programs.—Through the mortgaged-backed securities program, GNMA has pioneered the development of the secondary market for mortgage financing. We propose continuation of the mortgage-backed securities program at a level of $38.4 billion. The level proposed this year reflects a more realistic assessment of the amount of credit required to meet program demand in the current economic environment. It is important to note that the actual volume of securities issued has never come close to the levels now proposed. In addition, we are putting in place in fiscal year 1983 reasonable increases in commitment fees that will restrain unnecessary requests for commitments.

We believe that the reduction proposed in the fiscal year 1983 budget will not have a major impact on the amount of financing available to consumers for housing. By putting a realistic and practical limit on GNMA, we intend to send to the market a signal that there is ample room for private alternatives to grow and prosper, such as the new mortgage-backed securities programs of both the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation. We will continue to support the market but we are looking to private firms to play an increasingly important role in the rest of this decade.

Tandem termination.—We are not proposing any further funding for the GNMA Tandem Mortgage Purchase Program. This program has turned out to be much more expensive than originally contemplated and the effects often have not been focused on the truly needy. We can no longer afford the luxury of devoting scarce resources to public programs that are expensive yet often inadequate.

FAIR HOUSING

This Department is firmly committed to strengthening existing fair housing enforcement procedures. The Department has retained strong civil rights requirements to assure that its statutory responsibilities continue to be met. We are also strengthening the scope and quality of our monitoring and compliance activities. Connected with this effort is the establishment of mechanisms for the collection of accurate, timely, and adequate data to enforce our civil rights obligations.

NEW COMMUNITY DEVELOPMENT CORPORATION

Our goal has been to liquidate the New Communities program as quickly and as effectively as possible. The program initially provided guarantee support for debt issued for land acquisition and development for some 13 new communities. When I took office, last year, 9 of those 13 had failed financially and had been acquired by the New Community Development Corporation (NCDC).

I am pleased to report that through 1981 NCDC sold or partially disposed of five of the failed communities resulting in a return to HUD of approximately $34 million. The remaining four HUD-owned properties are scheduled to be sold within the next 12 months with an expected return to HUD of approximately $16 million. We estimate additional receipts to HUD of approximately $32 million from salvaged properties, for a cumulative total of $82 million.

CONCLUSION

The program changes and new directions being undertaken by this Department are important and necessary steps in reorienting Federal resources that no longer can be regarded as unlimited. We believe these scarce resources should be directed "toward people, not toward structures," in the words of the President's Housing Commission.

For the past year, this Administration has worked diligently to develop a more rational and economically viable approach to the problem of providing shelter for the Nation's poor and to attack the serious long-term budgetary problems created by the Section 8 program. We believe these proposals are cost-effective and needed, but, above all, are fair and equitable. I urge this Committee and the Congress to consider them carefully.

Senator LUGAR. If I have the unanimous consent of the committee, we will ask that in our questioning of the Secretary that we limit ourselves to 10 minutes of time, and if there are additional questions we will have another round. I want to make certain that each one of us has the advantage of questioning the Secretary.

NUMBER OF FAMILIES TO BE SERVED

In spite of considerable rhetoric and many strong words about the service of your Department to poor families in this country, could you give us some indication of the growth in the number of families that will be served in 1982 and in fiscal 1983? Do you have at your fingertips some trendline of the additional families that are being served in this fiscal year and the additional numbers that will be served in your proposals for 1983?

Secretary PIERCE. Let me put it this way. We have a trendline that goes between now and 1985. Right now there are about 3.3 million households covered and we intend to increase that over a time into 1985 to 3.8 million. So there would be one-half a million during that period of time. They will not be spread exactly the same each year. A lot will depend on the facts and circumstances in a particular year. But during that period of time we expect that kind of growth.

Senator LUGAR. In the situation of construction in fiscal 1982, the year you describe at the beginning part of your remarks, my understanding is that 250,000 new units of assisted housing will commence. Is that generally true or can you describe what type of new construction is occurring in fiscal 1982?

Secretary PIERCE. Well, in fiscal 1982, there will be new construction of section 8 projects because we still have section 8 projects in the pipeline. There will probably be some public housing units, but there we can't be exact because if the legislation we propose passes it will allow public housing authorities in the various cities to substitute the number of units they would be getting for building for modernization and it will be a 2-to-1 substitution—for every two that they give up for building, they will get one for modernization.

How well that will be received, I do not know. We will certainly continue to build in connection with the section 202 program as well. And then, of course, there is the tandem program for which a lottery was just held. So there will be building under that also.

There will be a substantial amount of building going on and I would think that your number may be correct. I don't know the exact number off the top of my head, but it could well be that number.

RENTS PAID BY FEDERAL GOVERNMENT

Senator LUGAR. Under the section 8 new construction program, the Federal Government is committed to pay rents for up to 30 years. How do the rents which the Federal Government is required to pay for a section 8 project compare to current market rates for nonsubsidized rents for similar buildings?

It's my understanding that the section 8 rents are as much as 20 percent higher than the current market rents for nonsubsidized buildings. Could you make a comment on that?

Secretary PIERCE. Yes. I think we can make it clear or put it in perspective. There's no doubt that section 8 rents are far more expensive and that over 50 percent of the people who live in section 8 housing pay much less rent on their part than the people who live in comparable housing in the same localities; meaning, of course, that the Government is paying this big difference.

Section 8 can be also compared to our new certificates where to build a section 8 new construction unit is about $6,000 and a certificate would be around $2,000, so you get roughly three certificates for one unit of section 8 housing.

By any comparison that you use, section 8 housing is extremely expensive. Perhaps the most expensive unit that has come to my attention is $17,000 for one unit, and that's a tremendous amount.

Senator LUGAR. Well, Mr. Secretary, why is this so? Why should section 8 housing have rent 20 percent higher than that found in the regular market?

Secretary PIERCE. Well, I think it's a combination of factors. First of all, it has a built-in inflation rate, so inflation as it goes on through the years continues to be accounted for in the section 8, and that's a lot of money.

In addition to that, we have been very generous with building costs, and then there are a lot of Government regulations and requirements that have to be followed. One of the big ones, of course, is the Davis-Bacon requirement which causes us to pay more money for construction costs than other apartments of similar size and so forth in the same localities.

Senator LUGAR. Mr. Secretary, if the Congress adopts a policy this year to fund the remaining units in the so-called pipeline, how much more additional authority in dollars on top of the quarter trillion dollars that you've already mentioned, which is already committed to be spent in the future—how much more will be necessary to make these projects work today?

More specifically, how much more in tandem funds and in FAF adjustments would be needed in your judgment?

Secretary PIERCE. Well, in tandem funds and FAF adjustments, I think we would be talking something in excess of $3.1 billion. I'd say about $600 million for the tandem and probably at least $3.7 billion for FAF.

Senator LUGAR. This would be additional expenses on top of the expenses for the pipeline?

Secretary PIERCE. Well, that would be in addition to what's in the pipeline already, including the lottery choices that have already been made. In other words, how are we going to take care of the losers. That's what we would be talking about.

Senator LUGAR. Will you explain your rationale for eliminating HUD's authority to set the FHA mortgage rate, in other words, to allow the rate to float with the market, and what has been the experience with the HUD-set rate over the past 5 years?

Secretary PIERCE. Well, it's been extremely hard to be on top of it at all times and no matter which way we seem to go we've received a great deal of criticism from one source or another. So I believe that the fairest way of doing it is just to have it connected with the market rate.

Senator LUGAR. What would be your reaction to a policy that would encourage the further development of the private secondary market programs by slowly raising the cost of GNMA guarantees to make the nonguaranteed mortgages backed securities more attractive?

Secretary PIERCE. Well, I don't think I would object to that.

Senator LUGAR. Very good. I'd like to at this point recognize Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Secretary, you sure have my sympathy. You have a very tough job, especially this year. HUD is always a tough job and I think you come at a time when it's probably harder than any other time.

We do have a tremendously difficult budget problem. HUD's operations are expensive. They do cost a lot of money. It's not cheap to build houses under any circumstances and, as a result, you have to take some difficult, painful, unpopular positions.

Yesterday, the President spoke to the realtors and was reported to make this statement, and I quote:

President Reagan rejected any budget busting bailout for the housing industry yesterday, despite warnings that Congress is prepared to approve deep subsidies of mortgage interest rates without White House support.

I take it that that would mean that the administration will not support and may oppose the Lugar proposal and the Jackson proposal, both of which would provide for subsidies of 4 percent for mortgages under certain circumstances and for certain homebuyers. Is that interpretation correct or not?

Secretary PIERCE. Well, the President hasn't made any final decision on the Lugar proposal. I am chairman of a task force that's been meeting on that and other matters relating to the economics of housing. We have given our thoughts to the President and he has them under consideration and I would think that sometime this week the President will make his thoughts known.

Senator PROXMIRE. Now I've found that there are certain problems as far as I'm concerned with the Lugar proposal and others. I wrote a letter to the Chairman of the Federal Reserve Board who responded that he would not accommodate the increase in credit which I calculated would be about $26 billion as a result of funding 400,000 mortgages at $65,000 each and, as a result, he concluded that this would mean that the credit would have to come from elsewhere in the private sector and there would be no net increase in jobs.

Nevertheless, I may support this bill because I do think that the homebuilders are in a peculiarly painful and difficult position and unless they get some kind of emergency assistance—and I see nothing in your statement that would provide them with emergency assistance--we are going to lose some of the most capable builders in this country, a tremendous asset.

Secretary PIERCE. I could not agree with you more. I think they are in a most difficult position.

Senator PROXMIRE. What can we do about something like this which I admit has all kind of flaws and difficulties with it, nevertheless, it is a sincere effort on the part of the chairman of the subcommittee to do something about an industry that otherwise is in the most serious danger? Do you have any other alternative?

ALTERNATIVE EMERGENCY ASSISTANCE

Secretary PIERCE. Well, we have other alternatives. I hesitate discussing them in detail because we're in the process of going over them right now in my committee, but there are other alternatives, we think, certainly maybe not as big as the Lugar or the Jackson proposals, but there are things that can be done.

For example, we think we can move a tremendous number of houses if we renew FAF and change it just a bit.

Senator PROXMIRE. If you do what, sir?

Secretary PIERCE. Renew the financial adjustment factor program and change it just slightly. We think we can move a number of houses in that way. We have already agreed to make changes in the mortgage revenue bond for single-family housing which would increase arbitrage and would increase the areas that would be covered by the bonds, and that, we think, will also bring about an increase in the movement of houses, both new and existing houses.

Senator PROXMIRE. Well, the virtue of the Lugar proposal is that it would provide 400,000 starts, maybe not all net, probably most of them not all net, but a substantial increase—a big increase. Is there anything in what you're discussing now that would give us anything like several hundred thousand new starts?

Secretary PIERCE. I can't tell you exactly, but I would say a minimum of about 120,000 existing and new houses. That's the difference. There will be some existing housing involved in the proposals I discussed.

Senator PROXMIRE. Well, existing, of course, doesn't help construction or jobs.

Secretary PIERCE. But at least 120,000, and there are other things we could do probably to increase that number. Also, one of the problems we've had when we worked on the economics of the Lugar proposal, is that we disagree with the estimates being made.

Senator PROXMIRE. By that, you mean you might not get the net increase?

Secretary PIERCE. We don't come out with the same figures, in other words.

Senator PROXMIRE. What figures do you come out with?

Secretary PIERCE. Well, talking from a point of view of impact on the deficit, we think there will be about a $3 to $4 billion cost involved over the next several years.

I think it was Mr. Ruckelshaus who testified before this committee and said the Lugar proposal would cut the deficit by $25 to $30 billion or something like that. We don't come anywhere near that kind of money.

Senator PROXMIRE. Well, I can't understand why you think the Lugar proposal would not work but the administration proposal would work.

Secretary PIERCE. No; I didn't say the administration's proposals would work. I didn't say the Lugar proposal would not work. I'm talking about cost factors, not about the Lugar proposal working.

Senator PROXMIRE. Let me ask you this. As I understand it, the administration has sent a rescission up for fiscal year 1982 of $7.5 billion of assisted housing funds which would knock out 64,000 units. Is that correct?

Secretary PIERCE. We have sent up a rescission for how much?

Senator PROXMIRE. $7.5 billion for fiscal year 1982.

Secretary PIERCE. I think that the total amount of our rescission is $9.4 billion.

Senator PROXMIRE. $9.4 billion, yes.

Secretary PIERCE. Yes; we have sent that up.

Senator PROXMIRE. Now that reduces the number of units that will be constructed. You have indicated that you might have something to bring up maybe 120,000 or so additional units. You end up with really very, very little when you see us 1 million housing units short of where we would be if we had a healthy homebuilding industry. Isn't that right?

Secretary PIERCE. Well, that is true, but you've got to understand that a lot of these units that we plan to cancel have been in existence for some time. They haven't moved. They haven't done anything. They haven't gone along. They haven't progressed.

Senator PROXMIRE. Well, they won't move unless you provide the financing for them. Take the money away, sure they won't move.

Secretary PIERCE. No, no, no; they have the regular section 8. They need something more, I guess, because they haven't moved.

Let's take, for example, a situation we just got involved in very recently, this 202 situation, which is similar to the section 8.

GNMA FINANCING

Senator PROXMIRE. The GNMA financing and the financial adjustment factor you mentioned just aren't working; is that right?

Secretary PIERCE. Well, with an increase in the financial adjustment factor we'll be able to move more, yes. There's no doubt about it.

Senator PROXMIRE. It assumes a 12-percent bond rate?

Secretary PIERCE. No; we want to go up higher. We'd like to have it so it floats with the market. Five-tenths of a percent below wherever the market goes. Right now the market rate is about 13.5 percent and we would like to have the FAI rate at 13 percent. If the market goes to 14, it would be 13.5. We think we would do better with that method than if we just set the rate at 13 or 12 or 14 percent.

What's happened in the past is we've set it and then before we know it, it's changed. We set it at 12 percent not too long ago and that's not good enough. We now need about 13 percent, but 2 months from now we may need a rate of 13.5 or 14 percent to move them.

Senator PROXMIRE. What we really need—and I think it's very constructive and helpful to talk about even minor improvements—what we really need is some kind of assurance, some kind of action on the part of the administration that will indicate that we are moving to a solution to our terrible fiscal policy. As long as we have a $100 billion deficit year-in and year-out, next year, the year after and so forth—and that's what the independent, private economists tell us almost unanimously—I don't see how we can get interest rates down and how we are ever going to get the homebuilding industry in shape.

Can you see any solution to that, other than to change policies so that we do cut spending and do increase revenues?

Secretary PIERCE. Well, I don't think we would change policies if we cut spending. I think the administration is very much going in that path of slowing down Government spending. That is certainly a very definite policy with this administration.

Senator PROXMIRE. Military spending, public works spending, space spending?

Secretary PIERCE. Well, we have not cut down on defense spending, but that does not mean that it might not be done in the future. But we have not cut down on defense spending. That is true. But generally spending in Government as a whole, we believe is being slowed down and——

Senator PROXMIRE. The key is the deficit.

Secretary PIERCE. Well, we believe in reducing the deficit, there's no question about that, and we think that one of the keys to doing that, of course, is to reduce the rate of Government spending, and we are very much in favor of doing that and we are trying very hard to do that and that is one of the reasons we can't move as many houses as some people would like us to move in the pipeline.

Senator **Proxmire**. Well, my time is up. I said at the start that I had great sympathy for you. I still do.

Senator **Lugar**. Thanks, Senator Proxmire.

Senator D'Amato?

Senator **D'Amato**. Thank you very much, Mr. Chairman.

MORTGAGE INSURANCE

Secretary Pierce, the FHA 223(f) program, the mortgage insurance, was designed to make multifamily refinancing attractive to lenders. I submit that the program has not worked nearly as well as it possibly could as a result of the unrealistically low ceiling, that of $3,000 per unit.

One of the very interesting programs that was undertaken—and I commend you and HUD for its leadership—was the PAP program in New York City where various areas were designated and that $3,000 limit per apartment was waived. It made possible the rehabilitation of 1,500 units in New York City.

My question is, will you be entertaining the elimination of that $3,000 limit so that moderate rehabilitation can become a reality?

Secretary **Pierce**. We will consider that. We are considering it and I can't give you an answer at this time.

Senator **D'Amato**. Might I suggest that I think it would be a very effective manner and an effective way in which to deal with the problem of the blighted urban areas, that before those buildings become totally uninhabitable, encouraging a greater movement in the direction of the moderate rehabilitation without having many of the problems attendant—the vacant, the abandoned buildings, the high cost attendant in other kinds of areas of new construction—that this might be an excellent formula and way to move forward on this.

What plans, Mr. Secretary, if any, do you have for dealing with the coinsurance. Do you in your new legislation intend to change any of the formulas so we can induce more private sector involvement in the area of rehabilitation and coinsurance in particular?

Secretary **Pierce**. No; we have not really pushed in that area.

Senator **D'Amato**. Might I suggest that there have been a number of financial institutions that have indicated that were they to have the opportunity of having the Government pick up the first 10 percent, for example, on a loss-guarantee, thereafter that they would think that coinsurance utilizing private funds with the Government might more realistically be able to meet some of the needs that heretofor we haven't met. I'd ask you to look at ways of making that coinsurance—opening it up to the private sector as a viable method of getting more investment in that area.

Secretary **Pierce**. All right. We will certainly look at that, Senator.

Senator **D'Amato**. Mr. Chairman, I have a number of questions, most of them which are technical in nature, and I'm wondering if I might not be able to submit them for the record so the Secretary could respond in writing at another time.

Senator LUGAR. On behalf of Senator D'Amato, I would ask the Secretary to respond to those questions in a timely way so our hearing record will be complete.

Secretary PIERCE. Certainly we would be glad to answer those questions.

Senator D'AMATO. Thank you very much.

Senator LUGAR. Mr. Secretary, I would extend Senator Proxmire's question just this far, that as you're well aware from the news accounts of yesterday, the housing starts were down to an annual level of 336,000 units as of February. In fact, at least the account I've seen over the wire service in the United Press International, it said it represents 26,000 new houses actually sold last month, which is the second worst month in 20 years of time.

One of the reasons for considering at least an additional program and one of the reasons why I and others have proposed such programs is simply a fear that there is something happening here in a historical way in the homebuilding industry, and that is especially as severe if not potentially catastrophic, and that the normal course of activities simply won't do.

You have offered a constructive set of proposals reiterating the President's speech to the realtors yesterday, and hopefully the 120,000 net units that you have anticipated may occur. And I do this because I know you're sympathetic with the general problem. If we do not really carefully consider how the new jobs are to be created in the economy in this particular time as the President's Cabinet group studying housing or other affairs is taking a look at these situations, what is the general prediction as far as the deficits that will be created from extended unemployment or extended bankruptcies in this industry and in others? In short, one rationale for the proposition that this subcommittee is considering is that we believe that additional income taxes would be paid by people who will find jobs and by those who employ them, and that the deficit would have at least some hope of being decreased in that fashion.

We are not certain that we see that occurring in the proposals that have been made thus far and to listen, I suppose silently, to an analysis in which it's predicted that the bill I presented could result in losses to the Federal Government of $3 or $4 billion is really absurd. Even Mr. Ruckelshaus' statement of $25 to $30 billion is euphoric; $3 to $4 billion loss is simply ridiculous.

Now I would hope that you would return to your colleagues in good humor and indicate that really another sort of analysis is required promptly, because this subcommittee plans to meet on Thursday for a markup of the bill that I've presented. I hope we'll be successful in pushing that to the floor and in having a first-class debate on constructive policy. I appreciate your good will in making as good a case as you could for it. Really you need not respond if you don't wish to, but I simply did not want to let this colloquy pass without making the record more comprehensive.

Secretary PIERCE. All right, sir. In fact, what I'll do is, I think for the record, I'll have our economists write something in it and let the people see how that analysis was arrived at.

Senator LUGAR. Very good.

[The following information was received for the record:]

Cost of the Lugar Propsal

The National Association of Home Builders (NAHB), the Office of Management and Budget (OMB), and the Department of Housing and Urban Development (HUD) have presented estimates of the net change in the deficit as a result of the Lugar bill. The results are summarized in the following table.

Change in Deficit [1] (dollars in billions)

	1982	1983	1984	1985	1986	1987	Cumulative
Homebuilder	-4.0	-12.3	-5.2	-1.6	-.1	+ .9	-22.1
OMB Alternative	(-1.1/ -2.2)	(+1.9/ +2.2)	+1.0	+1.0	+1.0	+ .8	+3.8/ +4.6
HUD Modification	(-3.4/ -2.5)	+1.0	+1.0	+1.0	+1.0	+ .9	+1.5/ +2.9

Obviously, the homebuilder estimate is of a different order of magnitude than either the OMB or HUD estimate. This is because it inappropriately relies on models of substantial multiplier effects, a major flaw in the analysis. The OMB range of $3.8 billion to $4.6 billion in cumulative costs reflects differences in the assumed level of housing starts. Their preferred "midpoint" assumption gives rise to a $3.8 billion cost estimate. The HUD range of estimates from $1.5 to $2.9 billion reflects differences in the assumed substitution effect. The preferred forecast is $2.9 billion. Thus the range of preferred estimates of HUD and OMB economists is $2.9 billion to $3.8 billion over the next five years.

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[1] These calculations are not in present value terms, and ignore recapture. For example, assuming a 15 percent discount rate, and recapture in an average of 12 years, the HUD modification numbers show the present value of net outlays to be between $2 billion and $2.5 billion, offset by any revenues generated in the first year. In addition, as the analysis below explains, substitution over time will make the program more costly.

Methodology

Because the proposed bill would have a variety of feedback effects on the economy and would affect resource allocation and tax revenues in some subtle ways, it is difficult to estimate its cost. In what follows we take a middle ground approach, attaching numbers where possible and discussing verbally things about which we have less information.

A central issue in estimating the "cost" of the bill is the revenues that it will produce. The problem, of course, is that the effect will not simply be increased revenues (and decreased unemployment compensation) from the production of the 450,000 units that the bill is expected to subsidize, but will depend crucially on the substitutions that are induced. Three types of substitutions are of major importance:

1. Substitution within the housing market. That is, the extent to which subsidized units would have been built anyway.

2. Substitution over time. That is, the extent to which units built now substitute for units that would have been built later.

3. Substitution among sectors. That is, the extent to which the borrowing induced by the program "crowds out" other investment or the extent to which "ripple" (or "multiplier") effects of the program stimulate other sectors.

With the exception of the ripple effects, these substitutions all suggest that the program raises less revenue than might be guessed at first. Precise estimates of the second and third types of substitution are very difficult. They involve issues (particularly the third) on which there is not a consensus. The numerical estimates presented account for the first type of substitution only. We then discuss in a qualitative manner issues involved in the second and third.

Substitution Within the Housing Market

Clearly not all of the 450,000 subsidized units are net additions. A crucial issue is estimating how much substitution within the housing market there will be. OMB and HUD have used similar methodologies, but have used some different assumptions. HUD estimates result in higher net new starts, i.e., less substitution. This is what causes the different net cost estimates in the above table. The OMB analysis is attached.

Table 1 derives the substitution effect for 1982. In other words, it presents estimates of the number of people who receive the subsidy but who would have bought a house anyway, and adjusts the 450,000 units for this. We assume (following the NAHB forecast) that there would be 700,000 single-family starts in 1982 without the program. Of these, about half would have been eligible for the subsidy. This is the "base for substitution" in the table. To find out how many of these 350,000 would actually get the subsidy we must estimate how many "new" homebuyers would also want the subsidy. The first column of the table focuses on affordability. We calculate that the 4 percent subsidy would allow 700,000 additional renter households to qualify for a $75,000 house and mortgage loan of $67,500. Hence, if we assume that all of these households want the subsidy, then total "demand" for the program will be these 700,000 plus the 350,000 "base for substitution." But "supply" is only 450,000. We assume that the supply is rationed equally between the two groups. That is, all eligible buyers have an equal chance of getting the subsidy. This assumption is where the HUD analysis differs from OMB's. In OMB's case, new entrants to the market have less of a chance of receiving the subsidy. Here the net effect is 42.9 percent (i.e., 450/1,050) times 700,000 or 300,000 additional homes purchased.

In the second column, we acknowledge that cash-flow affordability calculations overstate demand. That is, payments are lowered by up to 4 percent for only five years and the subsidy is paid back (albeit interest free). Hence, all of the 700,000 newly eligible renters might not choose to be in the program. Column 2 assumes that only half would, and it recalculates Column 1.

Substitution Over Time

It is likely that the main effect of the bill will be to shift production forward. That is, increased production now will be at the expense of future production. This is not a problem in itself, since the purpose of the bill is to solve a short run problem; but from the perspective of cost, it means that increased revenue now will be cancelled by decreased revenue later.

This effect should not be over-emphasized. The current effects of the bill will be on an economy that is well under capacity. In two or three years when the housing production is reduced, the economy will probably be in better shape, so that workers that are not employed in the housing industry will be better able to find work, pay taxes, and not collect unemployment benefits. Hence, there is no reason to believe that there will be one less person-year of work in future years for each person-year of work produced by this program in FY 1982 and 1983. To put it another way, the program results in a greater utilization of the economy's resources (particularly labor) now. This does not necessarily lead to an under-utilization later when the economy is more robust.

Crowding Out

It is certainly true that the borrowing induced by the bill, about $8 billion in mortgage debt and $1 billion in Treasury debt in FY 1982 - 1983, will "crowd out" some private investment. But this effect may be very small in the short run. The financial system has become much more elastic of late and, especially in the short run, portfolio shifts, private liquidity creation, and international capital flows can finance this sort of program with little crowding out. Over time, crowding out is more important. But the point here is that, as fewer houses are needed in the future (a reflection of more being produced now), more credit will be available for other uses.

On the other hand, the program will tend to have multiplier effects. This is because newly employed workers will spend more money and thus will induce ripples that will counter some of the crowding out effect.

There is little consensus on the magnitude of these effects. Complete crowding out is not a reasonable assumption about the short run. But the program will reduce private investment. Since we do not know how big the side effects will be, we assume that in the short run the net effects on the economy will be the same as those in Table 1.

Conclusion

Through 1987 the bill will involve outlays of about $5 billion. Our estimate is that in the first year or two it will stimulate between $2.5 and $3.4 billion in net revenue (tax revenue plus savings in unemployment compensation). These figures are derived in Table 2, which is based on OMB's Table 3 (Alternate Methodology, Column 3). This suggests a net "cost" over the period of about $2 billion. The calculations do not include recapture, which is not expected to generate additional revenue before 1987. To the extent that the substitution of housing production over time reduces future tax receipts, the cost will be higher. With complete substitution, such that all current revenue gains from employment effects are offset by less tax revenue in future years, the cost would be the entire $5 billion of budget authority. However, as explained above, this is a "worst case" estimate. Thus, the analysis suggests that the program will increase the budget deficit over the next five years by between $2 and $5 billion. Finally, the HUD and OMB estimates are rather similar, and very different from the NAHB estimates. While there may be disagreement about the cumulative costs of the bill, it is clear that it will not be a net revenue generator.

Table 1 [2]

Program Substitution Effect, Calendar Year 1982
(units in thousands)

A.	Single-Family Starts	700	700
B.	Ineligible Starts		
	House Priced Over $75,000 (42.9%)	-300	-300
	House Priced Under $75,000 Purchased for Cash (7.2%)	- 50	- 50
C.	Base for Substitution	350	350
D.	Units Assisted With $5.12 Billion in BA	450	450
E.	Net Renters that Purchase [3]	700	350
F.	Buyers Eligible for Subsidy (C+E)	1,050	700
G.	Percent of Eligible Buyers that Obtain Subsidy (D/F)	43%	64%
H.	Net Incremental Starts (E·G)	300	225
I.	Units Assisted that Would Have Been Purchased Anyway	150	225
J.	Substitution Effect (I/D)	1/3	1/2

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[2] Rows A to D in the Table are the same as in OMB's Table 1, Column 4.

[3] If interest rates fall from 16 to 12 percent, approximately 700,000 additional renter households would qualify for a $67,500 loan. Column 1 assumes that all of these would want to purchase a house. Column 2 assumes that half of them would.

Table 2
Program Revenue Effects
(using assumptions in Table 1)
Jobs in Thousands, Dollars in Billions

	FY 1982	
	Full Usage[4/]	Half Usage[4/]
Construction and Supplier Jobs	306	230
Total Construction Put in Place	14.4	10.8
Wage Bill	5.7	4.3
Personal Tax Payments (13%)	.9	.6
Social Security Taxes (12%)	.6	.4
Construction Non-Wage Earnings	8.1	6.1
Business Federal Taxes	--	--
Savings on Unemployment	2.1	1.6
Direct Tax Revenues	1.5	1.1
Government Support Cost	.2	.2
Reductions in Federal Deficit	3.4	2.5

[4/] Full usuage is the first case in Table 1, in which all of the 700,000 newly eligible renter households try to enter the program. Half usage is the case where half of them do.

OMB ANALYSIS

ANALYSIS OF HOMEBUILDER ESTIMATES

1. Analysis of homebuilder estimates indicates that the incremental 1982 housing starts range from 100,000-216,000--substantially less than homebuilder estimate of 330,000.

2. Net incremental starts over 1982 and 1983 are estimated to be only 15,000-33,000 units,reflecting substitution of 1982 starts for 1983 starts.

3. Estimates of the impact on the federal deficit are substantially less than home builder estimates as shown in table below.

	1982	1983	1984	1985	1986	1987	Cume.
Change in Deficit (dollars in billions)							
Homebuilder	-4.0	-12.3	-5.2	-1.6	- .1	+.9	-22.1
Alternative	(-1.1/ -2.2)	(+1.9/ +2.2)	+1.0	+1.0	+1.0	+.8	+3.8/ +4.6

4. Attached tables provide details.

Analysis of Homebuilders Estimates of Housing Stimulus

I. Homebuilder estimates of stimulus effects on housing market activity and housing market effects on economic activity and Federal budget deficit are based on a number of critical assumptions that are suspect.

Most critical assumptions are:

1) substitution effects of subsidized units;
2) level of baseline housing starts forcecast;
3) additional employment and income effects;
4) revenue changes derived from income changes;
5) expenditure savings resulting from changes in unemployment, and
6) net effect on federal deficit from stimulus

II. Substitution effects

Table 1 compares initial homebuilder estimates of incremental housing starts with alternative estimates.

-- Alternative estimates use different methodology and different baseline starts to estimate gross and net incremental effects.

- Base for substitution is number of 1982 starts estimated to be eligible for proposed interest rate subsidy.
- All four alternative estimates are larger than initial homebuilder estimate of 245,000 units.
- Alternative estimates assume 85% substitution rate consistent with previous econometric estimates.
- Gross incremental units reflect additional starts estimated to occur in 1982, and estimates are substantially below homebuilder estimated 330,000 units.

  -- Homebuilder methodology ignores transfer of housing starts between 1982 and 1983.
- Net incremental units reflect estimated additional housing starts over combined 1982 and 1983 time period.

Alternative methodology also assumes all eligible units in 1982 will take advantage of subsidy (pure windfall for those who plan to purchase anyway) and that substitution occurs as eligible, homebuyers who would have purchased in 1983, purchase in 1982 to obtain subsidy.

- Table 2 shows decrease in 1983 starts resulting from substitution effect.

III. Economic effects

- Table 3 shows economic effects of alternative estimates of incremental housing starts.
- Homebuilder methodology used to estimate employment and value added effects.
- In each case 1982 employment and value added impacts are lower than homebuilders estimates of 158,000 and $7.2 billion respectively.
- Estimates in Table 3 are overstated because they ignore substitution effect between housing and other economic sectors.
  - Homebuilder assumption of zero opportunity cost in reallocating credit resources from other sectors to housing is not valid.
  - While unemployment levels reflect underutilized labor resources, there is no evidence to support assumption of underutilized credit resources.
  - Credit recollocation will force some reductions in economic activity from other sectors that give up credit resources at margin.
  - Depending upon sectors losing credit resources, net economic effect could be zero.

IV. Effects on Deficit

- Estimates on deficit also shown in Table 3.

- Alternative estimates on revenue effects are lower than homebuilder estimates because of:

    1) lower incremental starts estimates;
    2) homebuilder estimate of social security marginal tax rate too high;
    3) estimates of business tax revenues by homebuilders ignore losses that are assumed to exist in construction industry.

- Alternative estimates also estimate separately effects of expenditure reduction for unemployment insurance.

- Homebuilder assumptions of $25 billion reduction in deficit for every 1 percentage point reduction in unemployment rate is inappropriate. Unemployment expenditure savings are only $7 billion per percentage point change in unemployment rate.

- Homebuilder estimates ignore decline in 1983 activity and the resulting increase in deficit.

V. Additional tables are provided showing details on substitution estimates.

Table 1: Program Substitution Effect, Calendar Year 1982
(units in thousands)

	Original NAHB Estimates of Base, Methodology, and Forecast	Different Estimates of Base			
		NAHB Methodology		Alternative Methodology	
		NAHB Forecast	Midpoint Forecast	NAHB Forecast	Midpoint Forecast
Single-family Starts	700	700	782	700	782
Ineligible Starts - NAHB Estimate	-455	N/A	N/A	N/A	N/A
Ineligible Starts - Different Estimate					
Homes Priced Over $75,000 (42.9%)	--	-300	-335	-300	-335
Homes Priced Under $75,000 Purchased for Cash (7.2%)	--	-50	-56	-50	-56
Base for Substitution	245	350	391	350	391
Units Assisted With $5.12 Billion in BA	450	450	608	450	608
Units Assisted That Would Have Been Purchased Anyway	-120 1/	-298 2/	-332 2/	-350	-391
Gross Incremental Starts	330	152	276	100	217
Net Incremental Starts	330	152	276	15 3/	33 3/

1/ Base for substitution X 50%.
2/ Base for substitution X 85%.
3/ Gross incremental starts X 15%.

Table 2: Program Substitution Effect, 1982 and 1983 - Quarterly

(Change in single-family starts, units in thousands)

Estimate of Substitution Effect	1982				1983			
	I	II	III	IV	I	II	III	IV
- Using NAHB Original Base	--	+116	+116	+96	--	--	--	--
- Using Different Estimate of Base								
-- NAHB Methodology								
• NAHB Forecast	--	+53	+53	+46	--	--	--	--
• Midpoint Forecast	--	+97	+97	+82	--	--	--	--
-- Alternate Methodology 1/								
• NAHB Forecast	--	+35	+35	+30	-21	-21	-21	-22
• Midpoint Forecast	--	+76	+76	+65	-46	-46	-46	-46
Midpoint Forecasts (Seasonally Adjusted Annual Rates)								
- Single-family Starts	608	728	896	876	976	1,156	1,308	1,268
- Total Starts	910	1,112	1,301	1,303	1,424	1,641	1,806	1,724

1/ Assumes that the portion of gross incremental starts that are "borrowed" from future time periods are all borrowed from CY 1983.

Table 3: DIRECT ECONOMIC IMPACTS
(Jobs in Thousands, Dollars in Billions)

Alternate Methodology	Mid Range	Assumptions	NAHB	Assumptions
	FY 1982	FY 1983	FY 1982	FY 1983
Construction and supplier jobs........	221	-106	102	-47
Total Construction put in place.......	10.4	-5.0	4.8	-2.3
Wage Bill.............................	4.1	-2.0	1.9	-0.9
Personal Tax Payments (13%)......	.5	- .3	.3	-.1
Social Security Taxes (12%)......	.5	- .2	.2	-.1
Construction Non-Wage Earnings........	5.7	-2.8	2.7	-1.2
Business Federal Taxes...........	0	0	0	0
Savings on Unemployment	1.4	- .7	.7	- .7
Direct Tax Revenues...................	1.0	- .5	.5	- .2
Government Support Cost...............	.2	1.0	.2	1.0
Reductions in Federal Deficit.........	2.2	-2.2	1.1	-1.9

NAHB Methodology	NAHB	Assumptions	Mid Range	Assumptions
	FY 1982	FY 1983	FY 1982	FY 1983
Construction and supplier jobs.......	281	119	153	66
Total Construction put in place......	13.3	5.6	7.3	3.2
Wage Bill............................	5.3	2.2	2.9	1.3
Personal Tax Payments (13%).....	.7	.3	.4	.2
Social Security Taxes (12%).....	.6	.3	.4	.2
Construction Non-Wage Earnings.......	7.4	3.0	4.1	1.8
Business Federal Taxes..........	0	0	0	0
Savings on unemployment outlays	2.1	.7	.7	0
Direct Tax Revenues..................	1.3	.6	.8	.4
Government Support Cost..............	.2	1.0	.2	1.0
Reductions in Federal Deficit........	3.2	.3	1.3	.6

Table 4: Estimates of the Substitution Rate for the Brooke-Cranston Program 1/

Source	Program	Rate 2/
	Long Run Estimates	
General Accounting Office		88.3%
Von Furstenburg		86.8%
	Short Run Estimates 3/	
General Accounting Office		84.2%
Hendershott		85.2%
Jaffee-Rosen		79.3%
Swan		85 to 88%
Von Furstenburg		83 to 89%

1/ Estimates of the substitution rate for the Lugar program were made in the fact sheet that accompanied the Lugar bill and in testimony before the Senate Housing and Urban Affairs Subcommittee on March 24. These estimates ranged from 82 to 90%. They are not listed in this table because it is not clear whether they were long run or short run estimates.

2/ Percent of total new units assisted that do not result in additional new starts.

3/ These estimates do not take into account declines in housing starts that may occur in subsequent years.

Table 5: Percent of New Home Buyers Who Utilize Mortgage Financing

	1979	1980
Houses Built for Sale	94	94
Contractor-Built Houses	80	78
Owner-Built Houses	60	53
TOTAL	85	82

Source: Census, Construction Report-Series C25. Total includes houses built for rent.

Secretary PIERCE. But there is a feeling that if you exclude the—we're not talking about what the recapture would be because that's too far away, but if you go only to 1985—and those are years we think about, I believe, there will be this kind of a loss because if you leave out the recapture it could be that large, or it could be up to maybe a $4 billion recovery, but it's in there. It's not anywhere near the amounts that industry representatives have claimed and I think it would be wise to insert this material because it was researched by the economists at HUD and the economists at OMB after they had had consultation with the economists of the National Association of Homebuilders and with the economists of the National Forest Products Association, as well as a Weyerhaeuser economist. So they've gone over this pretty well.

I will ask them to make a written report on this so all may see how they reached their conclusions. That's all I have to say about that.

PRESSURE FROM OTHER INDUSTRIES

One of the big things here I think, from the administration's point of view, is that there are a number of industries in very serious trouble—the automobile industry, steel—you can just go through a number of them. If you start helping one, you'll get pressures to help the others, and we'll be right back to the point of having a lot of Federal money spent without necessarily getting the money back. You'll go back to the same things that the administration claims it was trying to get rid of. So that is one of the major things.

Also, I think we feel as though the Reagan economic recovery plan has not been given sufficient time to actually work. More time is needed to see how well it really works. Those are some of the reasons for not going ahead at this time with a proposal like yours or any one similar to that.

Senator LUGAR. Well, I appreciate that.

Secretary PIERCE. I am not sure what the President will do. I want to make that very clear because the President has not made up his mind on this as yet.

Senator LUGAR. I appreciate that and I'm hopeful that you will continue to be as winsome as possible in court prior to that decision. Let me just say that I would accept clearly for consensus purposes that the proposal that I've made would result in some losses, particularly in the event that interest rates went higher. You know, one of the projections of the administration is that sometime within the next 5 years that long-term interest rates will come down. Under those circumstances, I don't see a way that you could lose in the proposition that I've presented. And in the event that interest rates stay very high or go up, then the recapture situation doesn't occur. As a matter of fact, lots of other disasters occur, in my judgment, if interest rates continue high for 5 years. But I would presume that economists making those assumptions could come up with some losses, as would I. It would just seem to me that we have to work on the assumption, as you are working, the President's program will work. I think we're also, consistent with that, trying tc give it some timely help. I'm sure my colleague, Senator

Riegle and I share an intense interest in trying to do things to help people in the automobile industry. I think we would share a feeling of trying to help people in the steel industry. As a matter of fact, almost every industry in my state could be helped and I'll be as diligent as I can to try to think of ways in which, consistent with the President's program, those constituents could be helped.

Let me yield to my colleague, Senator Riegle.

STATEMENT OF SENATOR RIEGLE

Senator **Riegle**. Thank you very much, Mr. Chairman.

First, I appreciate the initiatives that you have been taking on some of the housing-related problems that face the country. While we may not have precisely the same ideas, we're headed in the same direction. I hope that as the week goes forward we'll find that we can work things out here.

Mr. Secretary, I know that there is tremendous pressure within the administration to backtrack even further on some of the Nation's key housing initiatives. I know that you have fought hard in certain areas and with some success, certainly on the community development block grant program, and I thank you for that effort.

Looking, however, at the entire budget package, it seems to me we've now got a desperately serious problem. Whether you want to or not, you're presiding at a time when the housing, construction and real estate industries in this country are going down the drain. I think you're going to have to get more active and militant and creative in putting forward remedies. I hoped the administration would not simply remain silent or just say, well, the President's economic package is the best we can do. National leaders cannot just watch the massive collapse and liquidation of firms across the country that are well managed, that have been around for years, that want to function and that are needed for a healthy economy. We cannot simply say, well, that's sort of the breaks of the game; we're stuck with these huge deficits and stuck with the high interest rates and basically very little can be done about it. I don't think that's a sufficient answer. I don't know that you would want that to be your answer, to be your legacy to wear in future years—to be the Housing Secretary who was around and presided over that kind of a collapse.

But that is, in effect, what's happening. At the moment at least there's no proposal on the table from the administration to try to improve the situation or to work our way out of it. We are continuing to slide. The situation is worsening. I realize that everybody in the administration is part of the team and so it's not always clear how individual members of the team may feel about this part of the program or that part of the program. But I would hope that you would be the one leader and active voice within the administration and within the country who could start to ring this bell loudly enough and clearly enough that something starts to happen.

I think the President, frankly, is—I don't know precisely who's giving him economic advice on these issues—living in a dream world. The failure to understand the seriousness of the collapse that's taking place is so complete.

Out in Michigan, where we have 684,000 people unemployeed that we know by name and another 95,000 we don't count anymore because they have exhausted their unemployment benefits, people are wondering when we are going to see some initiative.

I had a group of realtors in my office just within the last half hour who are here because they are distressed because they and their colleagues are being driven out of business by the way the economy has dried up. The same is true with the construction people. The same with others. I just don't think it's sufficient to stand aside, as the administration is doing, and say, "Boy, that's really awfully tough luck that you're having out there, but there's really not much we can do about it." That's a cop-out. It's irresponsible and it won't work. You're going to see an upheaval which you're already beginning to see take place that will force a change in policy.

When groups like the Savings and Loan League and the realtors and the American Bankers Association and others connected with the industry are taking out full-page ads in the Washington Post, as they had to do 2 weeks ago, to try to express their degree of alarm and ask for a change in policy, it's obvious that they are having a hard time being heard.

Maybe you're having a hard time being heard. I don't know. But these messages must start to register. You folks need to come in here with something that addresses these problems, something more than just the status quo, something more than just retreat. You're going to have to come in here with something that's creative, something that addresses the problem, something to get new housing starts going, something to enable people to start moving from the houses they need to move from. And so we need something that is active, something that is specific.

I do want to know what your response is to the Lugar proposal. You can respond for the record or you can do it in person. We put forward on the Democratic side a proposal that is different in certain respects which Senator Jackson has taken the lead in putting together. I assume you've seen that. I'd like your views on that, on the details of that. But if you don't like the Lugar plan and if you don't like the Jackson plan, which I happen to be supporting, or some of the others that have been put forward, then I think you've got an obligation to come forward with your own plans, something more than what we see here. I would hope that there would be something we could see soon. If we don't, then I think we're going to find ourselves with our problems worsening, and I just think that's an unacceptable situation.

So I just hope that you can take those thoughts with you today. They are not just the thoughts of members of one party. What you see arising here, I think, in the way of an advance degree of concern is coming from people from both sides of the aisle. Thank you, Mr. Chairman.

Senator **Lugar**. Thank you, Senator Riegle.

Do you have a valedictory comment?

Secretary **Pierce**. Well, I guess the Senator said it all, but I'd like to say this; that we do have a task force that's working on this matter. We do review the various pieces of legislation, the Lugar proposal and so on. These matters are hotly debated and carefully considered and the President will come out with his final statement as to which way he thinks we should go, and I'm well aware of the problems in the housing industry and in fact in many other industries, some very closely associated with the housing industry such as the lumber industry, the cement industry, the plumbing industry, and a lot of others.

So I know the statistics and the problems well.

Senator RIEGLE. The question is, what are we going to do about it?

Secretary PIERCE. Well, if there was an automatic solution, none of us would have to be here worrying about it. It's not automatic. It's tough. We're working on it. It's not easy and we are doing what we can about it.

Senator RIEGLE. The question is, what are we going to do?

Secretary PIERCE. I can't tell you right now. I don't know the answer. I don't know whether anybody ever will know the answer. We have to try some things. We're doing what we can. We have a lot of ideas. We have some things that we are putting forward. We've put forward some already. We will put forward more. But we will have to do what we think is right and what the President, of course, finally determines is the correct way to go.

Senator LUGAR. Thank you very much, Secretary Pierce, for coming this morning. We deeply appreciate your testimony and your forthcoming answers to questions.

[Answers to subsequent questions follow:]

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

[illegible]

ASSISTANT SECRETARY FOR
LEGISLATION AND CONGRESSIONAL RELATIONS

QUESTIONS SUBMITTED BY SENATOR D'AMATO

Q. What changes are you willing to make in FHA 223(f) Insurance to make sure that it is usable?

A. The primary improvement in Section 223(f) that we are making is the implementation of the Section 223(f) Coinsurance program. Perhaps the major reason why multifamily project sponsors and lenders have not used Section 223(f) financing more is that the processing of applications often takes many months. The coinsurance approach reduces processing time, as lenders perform more of the underwriting and other processing themselves.

HUD also is studying whether any of the variations in Section 223(f) and Section 223(f) Coinsurance policies contained in the TAP demonstration or in Senator D'Amato's proposed legislation should be adopted for the general Section 223(f) program.

The proposed legislative changes include: (1) a special Section 223(f) Coinsurance sub-program for the TAP areas; (2) raising the rehabilitation costs ceiling; (3) permitting subordinated liens securing loans of State and local governments; and (4) payment of mortgage insurance benefits in cash. Should such changes be deemed desirable, HUD believes they could be effected administratively and we would prefer administrative action.

TAP projects are now entering the rehabilitation phase. We intend to wait until after rehabilitation is completed before determining whether to incorporate the following additional TAP provisions in the general Section 223(f) program: (1) 90 percent loan-to-value and loan-to-acquisition cost ratios; (2) mortgage term that is lesser of 40 years or 100 percent of economic life; or (3) new, special underwriting policies for projects in marginal urban areas. Although the changes discussed above might help, they are not sufficient by themselves to assure that the Section 223(f) Program will be usable. It is also necessary to reduce multifamily mortgage interest rates so that new financing for existing projects with moderate-to-middle-income tenants becomes generally feasible.

Q. The waiving of the ceiling limitations which were received for TAP made it possible to use 223(f) to rehabilitate 1504 units in New York City. Would you be willing to use what was learned from the TAP demonstration to change the 223(f) regulations?

A. With certain minor exceptions, the total cost of rehabilitation in the general Section 223(f) program may not exceed the greater of 15 percent of value after repairs, or $3,000 per unit. In the TAP program this limit was increased to $15,000 per dwelling unit. We would like to extend a similar increase to the general Section 223(f) program, unless the Davis-Bacon Act and related requirements would prevent us from financing rehabilitation that is significantly more cost-effective than is the case in our other programs. The Department is in the process of determining whether these requirements apply to moderate rehabilitation that exceeds the present limits of the general Section 223(f) program.

Q. The present HUD Coinsurance formula is that the bank takes the first 5 percent loss and then the remaining loss is split 85%--15%, with the FHA taking the 85% loss. Do you believe this formula will get underwriters to originate loans in high risk neighborhoods?

A. First, the background to the question is not accurate in its implication that a coinsurance program has existed but remained in limbo since 1974. This Department did not publish a final rule for Section 223(f) Coinsurance until July 2, 1980. The program set forth in that rule was limited to depository institutions and provided no specific guarantees to secondary market investors. The ensuing period of financial distress for savings banks and savings and loan associations effectively dampened their interest in originating and/or holding these long-term mortgages. Regulations revising the program, published on March 31, 1982, provide a secondary market by facilitating the use of GNMA-guaranteed securities and allowing mortgage companies to originate loans.

The loss sharing formula remains unchanged. This formula received careful Department-wide reevaluation resulting in a conclusion that no liberalization is feasible, given the greater risk assumed by HUD in fully insuring GNMA securities holders against default losses. It must be remembered that the Section 244 coinsurance authority required premium sharing "on a sound actuarial basis." The present risk and premium sharing provisions were formulated in light of this statutory mandate.

Section 223(f) was never intended to be a "high risk" neighborhood program. The regulations at Section 255.5 in fact prohibit coinsurance of mortgages pursuant to the special risk criteria of Section 223(e). However, HUD offers special procedures for older declining neighborhoods under the Target Area Preservation (TAP) regulations for Section 223(f). Responses so far to the March 31 revisions indicate considerable interest in the program (mainly on the part of mortgage companies).

Q. Would you consider a change modelled after the formula of the Small Business Administration loans, where the underwriters take the top 10 percent of the risk, and the government insures the remaining loan, provided the banks may have the opportunity to reinsure the top 10 percent loss with someone other than the government, such as a private mortgage insurance company, or a state mortgage insurance agency?

A. We certainly would be willing to consider alternative risk sharing formulas which are consistent with actuarial soundness. A 10 percent "top loss" provision based on the outstanding mortgage at the time of default appears to have merit. However, if reinsurance is permitted, the difference between HUD's rule and this alternative tends to become academic: whatever its risk share, the originator would purchase private reinsurance to cover it. In publishing the interim rule on March 31, the Department has invited public comments through June 1, 1982. In adopting a final rule, we will consider a change to permit reinsurance in the Section 223(f) Coinsurance program.

Question: How will the lowest income tenants be able to afford the increase in rents in a rehabilitated building if the rental assistance has dropped from $3,600 to $2,000?

Answer: Under the Section 8 Existing housing subsidy program the average annual subsidy in 1983 is estimated to be $2,400 per year, not $3,600. The $3,600 figure was the budget authority calculated on the assumption that families would make no contribution to their rent and that HUD would have to provide the entire amount up to the maximum, i.e., up to the Fair Market Rent. This provided reserves to be built up to pay for increased subsidies in the later years of an Annual Contributions Contract. While we expect an average subsidy to decrease, there is a provision in the bill limiting rent contributions for a previously assisted family. They will not pay more than an additional 20 percent of their pre-transfer rent payment per year. Our projections show that in the first year even a large low-income family would experience an increase in their rent burden that amounts to only one percentage point. In any case, families that are assisted will on average be receiving $2,000 more than families who are not assisted and will be paying $2,000 less in rent for standard units.

Q: Would you consider permitting the localities to establish a Fair Market Rent level on a neighborhood by neighborhood basis?

A: The current system used to determine Fair Market Rents relies on data from the Annual Housing Survey. This survey provides detailed information, including information on housing condition, only at the level of the SMSA. Confidentiality considerations prevent tabulations for smaller areas. We could not produce neighborhood level SMSA since we do not have the data.

Q: Would you consider giving the Modified Section 8 Certificate to the local government, and letting them establish the allowable rental assistance based on building conditions as well as on the Fair Market Rent of that particular neighborhood? The locality would be accountable, and would be required to certify all rent levels.

A: As stated in the previous answer, Fair Market Rent determination relies on data from the Annual Housing Survey. This survey does provide detailed information on housing condition, but only at the level of the SMSA due to confidentiality considerations. Therefore, we could not produce neighborhood level SMSA since we do not have the data. Local determination of the amount of rental assistance is a concept the Department considered but decided was too complicated to successfully administer nationwide.

Question: How does HUD propose to get private lenders to participate in the second half of the rehabilitation costs?

Follow-up Question: If the HUD bill does not include an inducement to get the private sector involved, how will these building owners in high risk neighborhoods get financing?

Answer: Obtaining private sector commitments for the financing of rental property rehabilitation in any neighborhood is difficult. However, HUD's experience in its ongoing Small Rental Property Rehabilitation Demonstration, a prototype for the Rental Rehabilitation Program, shows that obtaining lender financing for rental projects is a realistic goal.

To date, seven of the 23 cities participating in the Demonstration have obtained general lender commitments to make private sector financing available for their rental rehabilitation efforts. Another five are in the process of negotiation with lenders. Providing owners of rental property with an up-to-fifty percent public (loan or grant) equity payment is a very significant incentive for private sector financial participation.

Furthermore, in cases where this level of public financing is not sufficient, the proposed legislation for the Rental Rehabilitation Program does allow localities to use Community Development Block Grant or other public monies to supplement their rental rehabilitation funds. The proposed 50 percent "leveraging" requirement is not limited to private lender commitments, but can also be met by owner cash contributions and/or other public funds. HUD does not intend to make refinancing an eligible use of rental rehabilitation funds. However, the Department does propose to draft regulations defining "rehabilitation" to include construction "hard" and "soft" costs, such as architectural fees.

QUESTION:

Isn't the HUD proposal aimed at very low income neighborhoods?

FOLLOW-UP QUESTION:

How will the market rents in this type of building support the Rehabilitation?

ANSWER:

The Section 8 Existing modified certificate program is aimed at helping very low income persons afford modest, decent housing. The payment standard is based on the 40th percentile of standard rental housing in the community. A very significant percentage of the standard rental housing in the community will thus fall within the payment standard. Any neighborhood in which standard rental units predominantly rent within the modified certificate payment standard would be an appropriate neighborhood for use of the Rental Rehabilitation Program. The neighborhoods would thus extend from the very poorest up to moderate income neighborhoods.

HUD data indicate that there are large numbers of standard units within the proposed payment standard; there are also many more units which can meet the housing quality standards with only modest expenditure. The Rental Rehabilitation Program, by providing a locally controlled, targeted rehabilitation subsidy, can expand the number of units qualified for the modified certificate program by expanding the amount of rehabilitation which will be feasible to bring units to standard. If market rents (after rehabilitation) will support only a very limited amount of rehabilitation (even with a 50 percent subsidy) then use of the Rental Rehabilitation Program in that neighborhood will be limited to properties needing only the least rehabilitation to meet the housing quality standards.

It is true that the lower the payment standard, the more limited will be the choice of neighborhoods usable by certificate holders and, therefore, feasible for the operation of the Rental Rehabilitation Program. Not all substandard units will be feasible for rehabilitation through the Rental Rehabilitation Program (especially in the poorest neighborhoods). The effect of the 50 percent limit on the subsidy will be to "cream off" those buildings most feasible for improvement through rehabilitation. That is a desirable process because it ensures that limited public funds will be used on the most appropriate properties.

The point (in the comment accompanying the questions) that rehabilitation subsidies will accomplish more rehab for the public dollar in better neighborhoods is valid. That is because high rent neighborhoods have [redacted] rents which can support greater amounts of unsubsidized investment in the property.

A rehabilitation program in a moderate income neighborhood in which market rents for a decent unit are above the modified certificate payment standard will work except that the units will not be affordable to low income persons with certificates, unless there is an additional rental subsidy. That subsidy could be provided by adding to the front end grant for the investor and requiring that the funds be passed on to the tenant through project rent control agreements. The result will be that available subsidy funds will be concentrated on a smaller number of recipients. In addition, if the project rent limitations are for a short term, say from three to five years, then rents will quickly jump to market rates with virtually guaranteed displacement of the low income tenants after the rent control ends. If the rent limitations are longer, say 15 years, then we will have recreated the inefficient structure of the Section 8 production program.

Under the Rental Rehabilitation Program, if a locality wishes to do some rehabilitation in moderate income neighborhoods which will not be affordable to certificate holders, it may do so. But, since the primary purpose of the program is to make more housing available for a smooth-functioning modified certificate program, the program directs that the locality should strive to have 80 percent of the units rehabilitated be available at rents equal to or less than the payment standard for that area.

QUESTION:

What evidence do you have that Recourse Lending, which requires all investors to be personally liable, will encourage legitimate developers and owners to be involved in rehabilitated properties?

QUESTION:

Isn't the recourse lending requirement, which will by all accounts dampen the enthusiasm of investment in rehabilitation, likely to subvert the thrust of the President's economic recovery plans?

ANSWER:

Private lenders generally require recourse to the assets of the borrower as well as recourse to security property in most private lending transactions unless the loan is insured with some other party than the lender taking the financial risk. This is done not only to increase the assets available for attachment, but also to ensure the maximum degree of commitment of the borrower to the success of the project for which the funds are being used. It is for the same reason that the Department wishes to minimize the use of non-recourse financing under the Rental Rehabilitation Program. Too many government programs have suffered because the private business person assisted did not have sufficient "risk" to assure that he or she critically analyzed the real prospects for success at the front end and then later devoted the management and other resources needed to make the project succeed when the going became tough.

Both the Section 312 Rehabilitation Loan Program and the Small Rental Property Rehabilitation Demonstration required recourse lending. In the former, there has always been greater investor demand than supply of funds. In the Demonstration, which is in its early phase of implementation, there has already been strong investor interest despite high interest rates. For example, Requests for Proposals have prompted good response from investors in Ann Arbor, Michigan, Fort Wayne, Indiana, Central Falls, Rhode Island, and Kansas City, Missouri.

Based on our previous experience, we believe that in most communities there will be sufficient investors willing to take a personal risk to fully use all available funds and meet program objectives. The Administration's Bill, however, only proposes that non-recourse lending be avoided to the extent feasible. If it appears that special circumstances will exist in any particular community which make it not feasible to insist on non-recourse lending, the Secretary will have full authority to make whatever arrangements are necessary to assure that program operations are not unduly restricted by the non-recourse provision of the statute.

QUESTIONS SUBMITTED BY SENATOR DODD

Q. Is it true that under the Section 8 Neighborhood Strategy Area demonstration effort, HUD agreed to provide selected communities with specific allocations of Section 8 Substantial Rehabilitation authority? If so, please answer the following questions:

How many units were set aside for participating jurisdictions?

How much budget authority did this commitment represent?

Local governments were to agree to target these neighborhoods for revitalization. Would you describe some of the commitments local governments were expected to make and indicate the dollar value of the improvements participants agreed to undertake?

When communities were selected, were they assured that there would be sufficient Substantial Rehabilitation funds for lower income housing in an amount agreed upon by HUD?

How many units have been committed to date under this program? How many of these units have been completed and occupied?

How many communities are involved?

The U.S. Conference of Mayors has stated in testimony that 4300 units remain to be drawn down in FY 1982 and about 1300 units in FY 1983. Are these figures correct?

Will Neighborhood Strategy Area commitments be honored in the light of the Administration's proposed rescissions?

Should these communities not be honored, how will the selected communities complete the work started in agreement with HUD in FY 1979?

A. Under the NSA Program, the Department agreed to provide Section 8 units based on a two to five year schedule. This agreement was clearly contingent, however, upon sufficient funds being made available by Congress for the Section 8 program. Original estimates were for a total of 37,688 units to be rehabilitated over a five-year period at a total estimated budget authority (using FY 1978 figures) of approximately $5.16 billion. On their part, the participating local governments agreed to undertake a variety of activities. While the NSA applications did not always provide exact figures, local governments agreed to provide approximately $1.1 billion for the rehabilitation of over 162,000 units, and another $1.15 billion for public improvements and services, with this latter amount to come from CDBG funds (28%), Federal funds (58%) and local and private funds (14%).

NSA cities were assured only that funding for substantial rehabilitation would be provided to the extent feasible within the overall resources of the Department. Through FY 1981, a total of 29,031 units (or 77 percent of the original estimate) have been committed under the NSA program. Of this number, only 3,441 units (or less than 12 percent of the units reserved) have been completed and occupied. There are now approximately 146 NSAs in 111 localities (originally there were 155 NSAs in 118 localities). Units have been completed and occupied in only 59 NSAs as of September 30, 1981.

The figures on NSA requests for FYs 1982 and 1983 indicated by the Conference of Mayors are somewhat off; Departmental figures indicate 3,400 units in FY 1982 and 1,500 units in FY 1983. The Conference of Mayors figures are based on a survey of most, but not all, NSA localities and include units that were allocated in FY 1981 but not reserved prior to the end of the fiscal year. (The Department informed local governments in FY 1981 that units not reserved by September 30 would not be rolled over to FY 1982).

The available evidence does not seem to support the contention made by the Conference of Mayors and others that HUD should continue this very expensive form of subsidy in NSA cities, while we are terminating it everywhere else. The fact that less than 12 percent of the units reserved over the first three years of the program have been completed and occupied suggests that either the original estimates were too high or that the participating cities have not performed as well as expected.

Even without the proposed rescission, the Department has already determined that additional NSA units would be made available to participating cities only to the extent that their fair share allocation makes that possible. Where the fair share for the city or the allocation area in which it is located is less than the amount requested for the NSA, fewer units would be made available. NSA cities will have to decide whether to continue to commit assisted housing resources from HUD for their NSAs or to use these resources for other community needs.

We have also advised our field offices to consider priorities for NSA projects (as well as MBE's and historic buildings) in determining which projects to fund in their pipeline.

(Dodd - Q2)

Question: How many units of housing are expected as a result of administrative settlements between HUD and CDBG recipients to bring about compliance with HAP provisions?

Answer: Based on a recent survey of our field offices, we estimate that communities would need about 3,200 units of Section 8 New and Sub Rehab (2,400 in FY 1982 and 800 in FY 1983) as a result of "administrative settlements", such as contract conditions related to HAP performance.

Question: Will the absence of any additional federal housing construction commitments in FY 1982 and FY 1983 make it impossible for you to fulfill commitments made administratively and by the courts? Was any consideration of such commitments given to these commitments when budget recommendations were being considered?

Answer: Assuming no major new litigation or other changes in these trends, the Department should have no difficulty in providing this assistance from recaptures of existing contract and budget authority.

(Dodd – Q 2)

QUESTION: How many units of housing are expected at the local level as the result of court settlements reached on Community Development Block Grant (CDBG) complaints about compliance with Housing Assistance Plan (HAP) requirements of the Housing and Community Development Act of 1974?

ANSWER: The table below lists the number and type of Section 8 substantial rehabilitation (SR) and/or new construction (NC) unit reservations for the Department to meet the below listed court-ordered settlements involving Community Development Block Grant participants. To the extent that those units are not started in 1982, the starts should occur in 1983.

CITY	CASE NUMBER	NUMBER AND TYPE OF UNITS	
		FY 1982	FY 1983
Toledo, Ohio	Dotson v. HUD, et al.	151 NC	...
Norfolk, Virginia	Robin Hood Tenants Assoc. v. Thomas et al.	100 NC	...
TOTAL		251 NC	...

(Dodd-Q3)

Question:

One of your proposals would repeal significant portions of the Real Estate Settlement Procedures Act, including the provision that requires the borrower to be given the opportunity to examine the uniform settlement statement one day before settlement. Since the statement has to be prepared before the closing anyway, what rationale is there for not requiring it in advance, when it might be of use to the consumer?

Answer:

While it is true that settlement statements are prepared prior to closing, it is generally a matter of minutes or hours rather than days before closing. There are several explanations for this practice:

- Closing dates may not be firmly established due to contingencies or other uncertainties;
- The person conducting settlement is dependent on other settlement service providers to furnish cost information;
- Given the wide fluctuations in interest rates and points, lenders are often reluctant to furnish costs more than several hours prior to settlement;
- By tradition or practice, many closing agents do not prepare settlements more than a few hours in advance of closing; and
- Since few consumers request advance inspection, there is little pressure to collect and prepare information in advance.

The value of the advance inspection privilege is open to question on several counts:

- The Peat, Marwick, Mitchell Survey, conducted in connection with the preparation of the RESPA report to Congress, revealed that lenders, attorneys, and title insurers reported that less than five percent of their clients asked to inspect the settlement statement before closing. While 20 percent of the surveyed buyers indicated that they requested advance inspection, PMM believed that the proportion who claimed that they made the request may have exceeded the proportion who actually made the request;

- Only those costs known to the settlement agent at the time of the request must be disclosed. In view of the lack of cost information available in advance of settlement, the value of the partial inspection may be severely limited; and

- There are no penalties for non-compliance.

Question:

Please explain how the elmination of the prohibition against kickbacks and unearned fees, according to your rationale, "may impede the evolution of new innovative methods for delivery of settlement services."

Would you explain why you are seeking to repeal the provision that prohibits the seller from requiring the buyer to use a specific title insurance company?

Answer:

For the past year this Department has been reviewing various programs to determine which regulations are an unnecessary burden to our industries and do not provide real benefits to the public. One such regulation, imposed during the Carter Administration by "interpretive rule," stated that controlled business relationships may be a violation of the anti-kickback provisions of the Real Estate Settlement Procedures Act (RESPA).

The determination that this rule should be eliminated was based on several factors. Among the most important of these factors is the absence of a clear Congressional directive that Section 8 of the Real Estate Settlement Procedures Act apply to controlled business situations. It is inappropriate for a Federal agency to expand the sphere of prohibited actions without a clear Congressional mandate. The gradual accumulation of prohibitions and requirements through administrative action has produced endless red tape which has frustrated and burdened our industries in recent years.

Another factor in the proposal to eliminate the rule was the widespread uncertainty of the regulation's meaning and application. Since violations of these regulations are criminal offenses, it is absolutely essential that there be no uncertainty surrounding their terms. It is sufficient to say that certain types of relationships "may be a violation."

Finally, the Department was convinced that a removal of the prohibition against controlled business relationships would stimulate competition within the settlement services industry. We believe that this will benefit not only that industry but homebuyers and sellers as well. Although this initiative may have an impact on existing relationships within the title insurance industry, we are confident that the industry will flourish under the increased competition our deregulatory efforts will produce.

While the Department opposes the expansion of RESPA to prohibit controlled business relationships, we favor the continued use of disclosures to educate and inform prospective homebuyers about the settlement process. The special information booklet mandated by RESPA contains comprehensive information on how to select providers of the various settlement services. Having read and understood this booklet, consumers are free to select the company or individual of their choice. All providers of these services should be free to compete for their business.

QUESTIONS SUBMITTED BY SENATOR RIEGLE

Q. You have stated that FHA programs will be directed to homebuyers "unserved or underserved" by the private sector, and that serving "first-time and inner-city homebuyers" is an appropriate role for FHA. You propose to accomplish this by creating limited authority to insure various alternative mortgage instruments.

Can you explain how shifting FHA away from reliance on fixed rate level payment mortgages helps to serve inner-city homebuyers?

To the extent that FHA uses adjustable rate mortgages, don't we impose underwriting standards that would require prospects for rising incomes which could disqualify many inner-city residents who could qualify for fixed rate loans?

A. Our alterative mortgage proposals, including the Adjustable Rate Mortgage (ARM) and Shared Appreciation Mortgage (SAM), are designed to ensure continued access to mortgage credit markets, and to make home purchase more affordable for low- and moderate-income homebuyers. On this basis, both should should become widely accepted in inner-city market areas.

The ARM and SAM are very attractive to lenders and investors. Each offers a sharing of any outyear inflation risk between the lender (or investor) and the home purchaser. As a consequence, their availability should enhance FHA's position in the marketplace and assure increased mortgage credit availability to inner-city mortgagors.

As importantly, each new mortgage instrument provides the prospective homebuyer with an incentive to purchase. The Adjustable Rate Mortgage makes possible a lower initial monthly payment to the extent the the lender is not locked in to a fixed interest rate. Naturally, if interest rates rise, the owner must increase his/her monthly payment, however, the same is true if rates fall. Further, unlike conventional ARMs and VRMs available in the market today, our proposed ARM contains both annual and mortgage life limitations on increases in monthly payments resulting from interest rate rises. Like the GPM, or graduated payment mortgage, the Shared Appreociation Mortgage makes home purchase much more affordable than does a fixed rate mortgage. With market interest rates in the 16-17 percent range, the SAM offers a reduction in early year payments of as much as 30-35 percent in exchange for a percentage of net appreciation. For prospective homebuyers who would otherwise remain in rental housing, the SAM represents an opportunity to become homeowners and benefit, if only on a 50-50 basis, in any appreciation in the value of the home.

To the specific concern related to FHA underwriting standards, and whether or not inner-city residents could qualify for ARMs and SAMs, HUD's policy has been and will continue to be one of evaluatino creditworthiness at the time of application without consideration of future income prospects. This policy has been utilized in the Section 245 Graduated Payment Mortgage program, and we see no reason to change it.

Finally, it should be noted that we have proposed that the ARM and SAM programs be limited to only 25 and 10 percent of total SF activity. The majority of FHA activity will continue to be in fixed rate mortgages, and prospective homebuyers will be able to select the mortgage which best meets their needs.

(Riegle-Q2)

Q. Please explain what steps are being taken to assure that the TMAP program is capable of meeting an increase in demand for default assistance?

A. The program design of TMAP is sound and is expected to handle demand. The only situation in which TMAP could not handle the demand would be if there were insufficient funds available. In this case, the Department's Assignment Program would be available to help eligible mortgagors. Under the existing law, the Assignment Program may be used where TMAP is not "appropriate." An insufficiency of funds would be one factor rendering TMAP inappropriate.

Q. The Department proposes to require public housing authorities to use money allocated to them for new public housing development for modernization instead.

How would this affect projects ready to go to construction?

Would agencies be expected to cancel such projects and turn the new development funds to modernization uses?

A. The proposed $1.8 billion level for Public Housing modernization for 1982 and 1983 reflects the Department's estimate of the amount of modernization activity that could be feasibly undertaken during the period. Prior to the implementation of the Comprehensive Improvement Assistance program (CIAP) in 1981, modernization funding had never exceeded $1.0 billion in any year and was generally much less.

The actual amount of modernization undertaken and the selection of which Public Housing projects are to be cancelled depends entirely upon the decisions of local Public Housing agencies. Up to the total dollar limit of $1.8 billion, each local agency will be able to decide between additional modernization funding or continuing its projects now under development. Within the overall limit, the Department will retain a portion of Public Housing recaptures for PHAs which have very severe needs for modernization but which lack a pipeline of projects under development.

We would assume that those PHAs who have the greatest need for modernization funding will choose to convert more of their pipeline for this purpose. This will mean that if a PHA is already having difficulty maintaining the projects it has, it will be discouraged from adding more units -- while those PHAs who are managing well will be free to continue funding feasible projects still in the pipeline.

(Riegle-Q4)

Q. Isn't it a fact that the multi-family projects that were not selected to receive GNMA Tandem financing assistance in the recent lottery conducted by the Department are worthwhile projects that could proceed to construction within a matter of a couple of months, if adequate financing were available? In light of the serious plight of the construction and housing industries, does it make sense to allow these projects to be terminated, when they could provide jobs, stimulus for the construction industry, and decent affordable housing for low-income people?

A. Normally, almost all Section 8 projects have received long-term, Federally subsidized financing at interest rates below prevailing market rates. This financing subsidy has taken the form of a direct subsidy, as is the case with projects financed under the Tandem Program and the Section 202 Loan Program, or an indirect subsidy through the use of Federally tax-exempt bonds. Until recently, projects which were not successful in receiving a Tandem commitment had the option of availing themselves of the tax-exempt bond alternative as interest rates under Tandem and bonds have been roughly comparable.

As a result of the constant fluctuations and recent experience of rapid increases in tax-exempt bond financing this comparability with the Tandem financing approach no longer is evident. To correct this discrepancy in financial assistance the Department has instituted a policy of providing Financing Adjustments for Section 8 projects using the bond financing approach. Adjustments which are made using Section 8 authority are designed to neutralize the impact of fluctuating interest rates on bond financed projects by covering the portion of project debt service attributable to bond rates in excess of eight percent. The ceiling on interest rates is fourteen percent or one-half percent below the prevailing bond rate, whichever is the lower.

The Department recently announced an extension of the Financial Adjustment eligibility deadline to projects which can start construction by August 1, 1982 and also has opened up the program to those wholly assisted Section 8 projects which were not successful in the Tandem lottery. It is expected that these adjustments will facilitate the construction of up to 25,000 Section 8 units in projects which did not receive a Tandem commitment.

(Riegle-Q5)

Question 5

As you know, unless the Congress specifically acts to approve a rescission request within 45 legislative days of its submission, the rescission is, in effect, disapproved. A rescission of FY 1982 subsidized housing funds was requested by the President on February 5, 1982, and has not yet been approved.

Should the clock run out on the rescission, how long would it take the Department to allocate the funds to the field?

Answer:

In the event that the President's request for the rescission of FY 1982 subsidized housing funds is not approved by the Congress, a number of actions would be required before these funds could be obligated. These actions would include HUD's submitting a reapportionment request to OMB and getting its approval, preparing an advice of allotment based on the reapportionment and developing an assignment plan in order to provide the allotted funds to the Department's field offices. It is anticipated that this process could be completed within four to six weeks.

(Riegle - Q6)

Question: What evidence does the Department have to indicate not only that market areas across the country contain enough suitable existing housing to support a housing assistance program based on the existing stock, but also that the types of units available in these areas adequately match the types of households that would receive the assistance?

Answer: Our eight years' experience in the Section 8 Existing housing program has shown us that most households could find standard units even in tight markets. The "rent cap" feature of that program however, made the certificates harder to use in certain tight markets than would have otherwise been the case. In the Section 8 program, families could not rent units at rents higher than the Fair Market Rent. In the modified program, we are proposing that families be allowed to rent units that are higher as well as lower than the payment standard. Their subsidy will not vary with their rent. The program will give them extra purchasing power and more freedom of choice in competing for better housing units. The Section 8 Existing housing program currently serves 700,000 households of various sizes. While larger households sometimes have problems locating units in certain markets, this is often because of the rent cap. By removing this cap, the modified program will be better equipped to serve such households in all markets.

(Riegle-Q7)

Q: Under the Administration bill, persons receiving Section 8 modified certificates would receive subsidies for up to five years, but the level of subsidy would remain constant though rents may rise. Isn't it conceivable that without some upward adjustment in the subsidy to take rent increases into account, tenants may find themselves occupying assisted units they can't afford and thus may be forced to move?

A: The Administration bill contains a provision that protects families who are currently in other HUD programs from rent contribution increases, due to program rule changes, that exceed 20 percent per year. We expect that more than 80 percent of the families participating in the program during the first few years will be "transfer" families and would get this protection.

Fiscal responsibility forced us to impose a ceiling on the maximum subsidy a family can receive during the five years of the ACC. The subsidy will not be "constant" since it will go down as incomes rise relative to rents and rise again, up to the maximum, as incomes go down.

It is conceivable that as rents increase families will have to pay a larger portion of their income for rent if they want to remain in the same unit. However, the assistance we are providing (on average $2,000 per year) is considerable. Even with rent increases, assisted families will be better off than families who are not assisted.

(Riegle-Q8)

Question 8

In a document that you transmitted to David Stockman on December 2, 1981, you appealed a number of housing proposals that OMB had under consideration at that time, and that despite your efforts have found their way into the legislation you have presented today.

The appeal, for example, state "The Department requests $1,373.8 million of budget authority for operating subsidies for 1983. Even this level is well below the estimated need of $1,583 million based on the most recent data." Now the Department seeks to justify an operating subsidy request of $1,075 million for FY 1983. Has anything transpired between December 2, 1981, and March 30, 1982, that revises your estimates of true public housing operating subsidy needs?

The appeal also complains about the OMB proposal to terminate the housing counseling assistance program, which aids local agencies in counseling clients who are delinquent or in default on their mortgages. OMB, of course, prevailed, as the legislation reflects. The appeal states the following: "This program has been repeatedly proven to be cost-effective in preventing FHA insurance claims. Failure to fund the program will mean higher outlays to the FHA fund." Is this statement no longer accurate? If not, why not?

Answer:

The following revisions have been made to the 1983 Public Housing Operating Subsidy estimate of December 2, 1981:

— The estimated inflation rate for operating costs has been revised downward from 8.6 percent to 7.5 percent annually to reflect the impact of currently declining trends in inflation.

— Increases in rental income resulting primarily from increased income of tenants has been revised from 6 percent to 7 percent annually to reflect more recent data.

— New Public Housing tenants will be charged rent at 30 percent of their adjusted income.

— The value of food stamps will be included in the calculation of tenant income for determining rent.

— The maximum percentage increase in tenant rents will be increased from 10 percent annually to 20 percent annually.

— The current estimate reflects decreased energy consumption based on the experience in private housing and the impact of modernization funding used to reduce energy consumption.

- Savings are also projected for Public Housing administrative costs due to deregulation, including the simplification of lease and grievance procedures.
- The revised budget estimates that State and local governments will provide increased support to the operation of local Public Housing projects.

Over the past several years, there have been a number of HUD studies designed to determine the cost-effectiveness of housing counseling in reducing the number of defaults and foreclosures of HUD-insured single family mortgages. One such demonstration concludes that the provision of such services to defaulting mortgagors does not reduce the probability of foreclosure in the long run. Another study has shown that, in the short run, counseling may reduce the probability of foreclosure, but this and other studies indicate that such results vary considerably depending on the client, agency and method of counseling. When these studies are analyzed collectively, evidence as to the effectiveness of counseling is inconclusive. Therefore, in a period where scarce Federal resources must be provided to fund services of proven effectiveness, it is not prudent to fund this program. However, pursuant to Section 106(a) of the Housing and Urban Development Act of 1968, as amended, the Department will continue to certify and/or recertify local public and private nonprofit agencies which provide HUD-approved housing counseling.

(Riegle-Q-9)

Q. The Administration has proposed a significant reduction in the commitment authority for GNMA mortgage-backed securities from $68.25 billion in FY 1982 down to $38.4 billion in FY 1983. You have stated that this is a "more realistic assessment of the amount of credit required to meet program demand in the current economic environment."

The HUD budget projects $35 billion FHA commitments and $22 billion VA commitments for FY 1983. In 1980, FHA issued commitments for $30.6 billion in FHA mortgages and $6.3 billion in VA mortgages resulting in a total GNMA commitment of $36 billion.

If HUD predicts more FHA activity in 1983 than in 1980, how can this severely reduced level for GNMA be able to accommodate the demand?

If GNMA levels are cut back, what private sector programs are now in place that could pick up the slack in marketing FHA and VA mortgages?

A. A distinction must be drawn between GNMA commitments and issuances. While commitments have been at high levels in the past, the actual issuances, or ultimate use of these commitments has never exceeded $23 billion, even in our most active year. There has clearly been "warehousing" of GNMA commitments in the past, in amounts greatly beyond that required by any market purpose. The reduced commitment level proposed for FY 83 is adequate not only to surpass our previous record high for GNMA security but to allow some "warehousing" beyond that. The aims in reducing the total commitment authority, and in instituting for the first time a schedule of commitment fees based on commitment size, are to cut back on excessive warehousing and to send a signal to the market indicating the Federal government's encouragement of private firms to enter the mortgage-backed securities business, because there will be some kind of definite and realistic limit on the amount of the market the Federal government will appropriate to itself.

If GNMA commitment levels were actually cut back so much as to be unable to accommodate reasonable foreseeable demand, which is not presently proposed, there are already operational several private and quasi-private mortgage-backed securities programs and close analogues to the GNMA program which can be expected to develop quickly in a resurgent housing market. Among these are the programs of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Mortgage Guaranty Insurance Corporation, and the Bank of America.

Question 10

The Administration proposes to lower the ceiling on the amount of FHA mortgage insurance that may be committed in FY 1983 to $35 billion, $5 billion below the amount approved for FY 1982. Should interest rates drop sufficiently to cause an upsurge in the use of FHA, and the ceiling proposed by the Administration be breached, would the Administration come to Congress to raise the ceiling, or would the FHA simply shut down?

Answer:

The FY 1983 projections are based on an improvement in the economy. It is inappropriate to compare the $35 billion ceiling for 1983 with the $40 billion limitation for 1982 — since the 1982 limit is unrealistically high. Insurance commitments ran $23.6 billion in 1981 and are projected at $28.6 billion in 1982. Therefore, the $35 billion limit proposed for 1983 would represent considerable expansion in activity. Nevertheless, the use of the commitment limitation is monitored monthly, and if HUD should begin to approach the limit during 1983, the Department would immediately consider seeking a supplemental appropriation.

Mr. Secretary, we understand that one of the reasons the Department and the Administration oppose further Section 108 Loan Guarantees is the use of the Federal Financing Bank (FFB) to purchase the notes from local governments. Is the use of the FFB a statutory or a regulatory requirement? If it is a regulatory requirement, why doesn't the Department simply alter its regulations to eliminate the FFB sale?

The Department does not oppose the use of the FFB with respect to Section 108.

The use of the FFB as the sole lender under Section 108 is a regulatory requirement, not statutory.

We believe the use of the FFB facilitates the administration of the program and results in a substantially lower cost to the borrower. From the standpoint of debt management by the U.S. Government, channeling these loans through the FFB provides improved coordination and control of borrowing.

However, it is the Administration's position that, in order to reduce the pressure of federal borrowing, the Section 108 Loan Guarantee Program should be terminated in fiscal year 1983.

This is being effected in a graduated fashion by our proposal for a level of commitment of only $125 million in fiscal year 1982, a reduction of $100 million from the amount authorized.

Has the Department investigated what impact freeing the Section 108 loan program from the FFB would have on its operation?

We have investigated this matter and concluded that disassociation with the FFB would significantly increase the burden on the Department and on the Cities of administering this program. Under the present arrangement with the FFB, the administrative burden is minimized.

Does the Department believe that private lenders would be willing to buy these notes directly from local governments if they were covered by the Section 108 guarantee?

For an interest rate considerably in excess of that charged by the FFB local governments could probably sell Section 108 guaranteed obligations to private investors.

What is the current cost to the Federal government of issuing these notes? In other words, what is the average interest rate on the outstanding loans, and what servicing fee, if any, does the FFB charge the local government making the loans?

There is no cost to the Federal government. The cost (i.e., the interest rate) to the borrower is equal to the rate the Treasury would pay on its debt with terms comparable to the guaranteed obligations, plus one-eighth of one percent. A separate rate is established for each loan, depending upon the rates on Treasury obligations at the time the loan is guaranteed. We do not have information available as to the average interest rate on outstanding loans. Neither the FFB nor the Department charges the borrower a servicing fee.

Does the Department know whether eliminating the FFB from this program would increase, decrease, or have no effect on the overall cost of the program to local governments? In other words, would individual placements of these notes entail a higher servicing charge for private sector underwriters?

Eliminating the FFB would increase substantially the cost to local governments. Based on our discussions with private investors, local governments could expect interest rates on privately purchased obligations to be 100-300 basis points higher than FFB rates. Local governments could also expect to pay issuance costs (e.g., underwriting and legal fees) on privately purchased obligations, whereas they pay none on FFB purchases. These issuance costs could add 500 basis points to their borrowing costs.

Has the Department investigated whether or not private underwriters would be willing to underwrite these obligations without the FFB, given the highly uncertain nature of the security offered, considering the Administration's proposals to fold CDBG into some larger "New Federalism" trust fund?

We have not discussed with private investors their willingness to purchase guaranteed obligations since the announcement of the Administration's proposals. Nevertheless, we think it likely that these obligations could be marketed to private investors, for a price, since the Department has borrowing authority with the Treasury. This borrowing authority could be utilized if the security (e.g., pledged grants) proved to be insufficient. However, investors would reflect greater uncertainty by charging considerably higher interest rates and issuance fees.

Senator LUGAR. The Chair now calls a panel on public housing, Jack Quinn, executive director, Housing Authority of the city of Pueblo, Colo.; Harry Spence, Director of the Boston Public Housing Authority.

Mr. Quinn and Mr. Spence, we are delighted that you are here to offer testimony as people who are on the firing line and with hands-on experience literally. We appreciate your return, Mr. Spence. You testified before in a most helpful way to the subcommittee just a few months ago and we are delighted that you're here, Mr. Quinn, to give us additional insights.

I'd like to call first on Mr. Quinn for his testimony and then on Mr. Spence. I will then raise questions and other members of the subcommittee may join us during that period of time. Mr. Quinn, will you please proceed?

STATEMENT OF JACK QUINN, EXECUTIVE DIRECTOR, HOUSING AUTHORITY OF THE CITY OF PUEBLO, COLO.

Mr. QUINN. Thank you.

[The complete statement follows:]

TESTIMONY BEFORE THE SENATE SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT GIVEN BY JACK QUINN, MARCH 30, 1982

Chairman Lugar, and Distinguished subcommittee members: It is my distinct privilege to be invited to offer testimony before this group on a subject with which I am most familiar.

My name is Jack Quinn and I am the executive director of the Housing Authority of the city of Pueblo, Colorado. I am also past president of the Mountain Plains Regional Council of the National Association of Housing and Redevelopment Officials (NAHRO)

As you probably know, national NAHRO has a current policy statement which is two-tiered—(a) an adequate level of operating subsidy with a three year cap, and (b) local flexibility in the determination of rents. I wish to state that I am in wholehearted support of the NAHRO policy statement. However, I must point out that, in this testimony, I am not an official NAHRO spokesman but am speaking as a concerned director and citizen, who knows that changes must be made and who has worked for many months now to effect some of those changes.

Gentlemen, I have worked in the field of public housing for almost fourteen years and obviously must have some sense of dedication to my work and compassion for the people whom my agency serves. If not, there are certainly other ways to make a living.

While I do truly enjoy the work I am doing, there is no doubt in my mind that we have reached a point in time where, after taking two steps back and surveying the situation, it has become abundantly clear that we now must take bold decisive action. Band-Aids won't help. The level of operating subsidy necessary for survival for most PHA's has grown in unbelievable proportions. Because now so many Congressmen and others are questioning this ever-burgeoning expenditure, our very existence is in jeopardy and along with it the shelter for the millions whom we serve. We all realize something must be done.

When I started with the authority in 1968, we were a "profit making" operation—we took in more in rents than we spent. I have here a color-coded bar graph which shows what happened to our income/expense ratio in eleven years. The blue bars represent income; the green, expenses; and the red, operating subsidy.

As you can see, for fiscal year end 3/31/71, we "made" $23,000. Enter the impact of the Brooke amendments with the "Secretary's definition of income." The following year we lost $16,000. And the graph goes on to show that for the fiscal year just ending, we required an operating subsidy of about a quarter of a million dollars.

In terms of the national scope, we are not a large agency. Yet, if we go from a cash positive position of $23,000 to a cash negative position of a quarter of a million dollars in eleven years, it is apparent what this bodes for the rest of the country.

What are the causes of this problem and what, then, are the solutions?

The causes are many, inflation and energy being two of them. But inflation and energy are almost beyond our control. However, in our opinion, there is one major cause of this problem and that cause can be corrected. The cause to which I refer is the Brooke amendment and Secretary's definition of income.

Up until the passage of the Brooke, housing authorities were on sound footing. Most received no subsidy and those that did received very little.

From the time of passage of the Brooke, housing authorities have been going downhill. While it is understood that Senator Brooke was well intentioned when he introduced his bill, by the time it was put into effect by the Bureaucrats, the ultimate ramifications of it made it what I consider to be the most devastating piece of legislation in the history of public housing.

What are some of these negatives:

(1) It set up tremendous inequities between the "working poor" and the public assistance recipients, to the point that it encouraged, in some cases almost dictated, that people be on public assistance rather than work.

(2) The percentage of income system encourages cheating by mis-representing or not reporting income. The honest ones pay the tab.

(3) By raising rents every time someone gets a raise or another family member gets a job, it stifles initiative and self/motivation.

(4) The ludicrous system of deductions off of gross income, mandated by the Secretary's definition of income, makes the concept of "25 percent of income" a sham. When one gets through applying the deductions and the utility allowance, no one pays anywhere near 25 percent, most are around 15 percent, and many are less than 5 percent. You've all heard about the "negative rents" where we mail our tenants a check. An unbelieving state of affairs.

In one of the documents I have handed out you will see where I used an example of one of our tenants in the section 8 existing program (a family of 2 adults and 10 children) who receive an ADC check of $750/month. The rent on his 6 bedroom house is $485/month, toward which he pays $17 and we mail the landlord a check for $468 each month. Nobody can tell me that's right.

Just the other night I was visiting with two friends who happen to be Hispanic. One was born and raised in the farm labor camps in southeastern Colorado, the other grew up in Old Mexico. One works in Spanish-Language radio and was recently the mayor of our city. The other has spent years working in the field of migrant education and is currently a program administrator at the local university still working with products of migrant camps.

Both decried the tremendous dependency syndrome we have set up, such as what I have just referred to. They see the fiber of their people being ruined by the system—a system which penalizes those who attempt to better themselves, and rewards those who can "play the system". One was most concerned as he talked of "14 year olds being taught how to fill out welfare applications."

It is a routine occurrence in our occupancy section to see an elated female head of household come in to tell us she is getting off of ADC because she found a job; and to see that same person dejectedly return a month or two later to explain that she had to go back on ADC because she was better off. We have just ruined another human.

As strange as it sounds, the people most well-off of all the low-moderate income people in Colorado are the ADC recipients living in public housing (or on section 8). This is because since the Brooke does not allow us to collect in rent, the amount the ADC recipient is actually receiving for "shelter", they end up paying us significantly less than they receive. For example, they are allowed $98, we charge $20; they are allowed $110, we charge $30. Yet, in the private sector, their ADC counterparts are paying about 40 percent more than they are allowed for shelter, and are usually living in units not nearly as nice as ours. At the same time the working families we serve are paying rent out of their net income (after taxes, FICA and medical insurance deductions) but that rent has been based on adjusted gross income. Again, what incentive is there to work?

The irony of all this is that while it was Senator Brooke's intention to help the poor, we find that only about 15 percent of the ADC recipients in any county, are being assisted by the local authority. That is because the need to be "financially solvent" necessitates the housing of higher income families. Most ADC recipients would gladly pay us their "shelter allowance" in order that they could live in our units. However, we can't accept it, therefore, don't house them and they are forced to fend for themselves in the private market. A real Catch-22.

Now, then, what about a solution. I spoke earlier of the NAHRO proposal for local flexibility in setting rent schedules. In your packet is a document which is entitled "a sensible solution for low income housing". That document discusses three methods of calculating rents—percentage of income, minimum rents and flat rents. I will touch briefly on the latter which I personally, support.

The flat rent concept is based on receiving an income stream which is equal to operating expenditures plus 10 percent for replacement reserve. Rents would be set by the local boards of commissioners (and approved by HUD) at an amount geared to achieve the necessary level of income. Rents would be based on bedroom size and would not change because of income. In my community, we project a present cost of $130/month for a 2 bedroom and $150/month for a three bedroom, all utilities included. These rates are about 40 percent less than ADC recipients are presently paying in the private sector.

I have included a bar graph done by the Fresno (California) housing authority showing various rent levels under different rent-calculation methods (including the current OMB proposal). It is interesting to note that in California the flat rents would virtually equal the ADC shelter allowance. The figures we have developed in Colorado, as well as the ones I have seen from several other states, indicate the same ratio. Thus, under a flat rent system, the "poor" really would not be hurt. It is also interesting to note that the proposed flat rent system is significantly lower than the current OMB proposal.

In addition, by going to such a system, we can finally attempt to correct the problems stated earlier: There will be an incentive to work; there will be no penalty for improving onesself; there will be no penalty if another member of the household gets a job; there will be no advantage to cheating in reporting income; and there will be a return of self-pride.

The system, as proposed, would, after a three year phase-in period, result in a tremendous decrease in the current level of operating subsidy. While we realize that the unique problems of the older, larger, eastern housing authorities necessitates continued funding, it is our considered opinion that for the other 5,400 housing authorities across the country, we could be virtually self-sustaining—as we were pre-1971.

It is my opinion that under this plan, no one would be hurt and through our continued survival, the low and moderate income families could continue to be provided with decent, safe and sanitary housing, just as they have for the past 45 years.

We have heard some of the "harbingers of gloom" suggest that it would be a mistake to turn the control of the PHA's over to the boards of commissioners because some might discriminate. To take such a posture would be a classic example of "management by exception" because to put shackels on the many because of a suspicion of the few, is hardly an efficient way to run a railroad. In addition, let's not forget, under our proposal HUD still has the right to approve the rent schedules and also still retains the rights it has for its equal housing opportunity reviews. Personally, we trust the appointed boards of commissioners.

The solution seems so simple, we wonder what's the big problem.

Gentlemen, that's our proposal. I thank you for your time. I would welcome any questions.

Senator LUGAR. Thank you, Mr. Quinn.

Mr. Spence, would you proceed with your testimony?

STATEMENT OF HARRY SPENCE, DIRECTOR, BOSTON PUBLIC HOUSING AUTHORITY

Mr. SPENCE. Good morning, Mr. Chairman and members of the audience.

My name is Harry Spence. I'm a court-appointed receiver of the Boston Housing Authority. I am speaking today as a spokesperson for the Council of Large Public Housing Authorities. The council was formed last year in response to the unprecedented crisis provoked by the Department of Housing and Urban Development's refusal to ask the Congress for adequate funds for public housing operating subsidies. I am here today to tell you that the outlook for this year is much worse than it was last year, and the future is exceedingly grim. If public housing operating subsidies are limited to the levels currently being proposed by HUD, the council believes that within a few years there will no longer be any public housing in many large cities in this Nation and across the Nation that can provide shelter for low-income people as historically intended by this Congress.

My testimony is divided into three parts. I'd like briefly if I could to insert a few comments because Mr. Quinn and I take two different views of some of these issues.

I believe that the housing system of this Nation is struggling with the sea change, a sea change caused by two factors: (1) Enormous increases in utility costs, and (2) interest rates. It's my belief that to blame the Brooke amendment for the problems of public housing is to shoot the messenger.

TRICKLE-DOWN THEORY

What occurred and what has occurred is that we've had a system for the last number of years, fundamentally a trickle-down system, of housing that has worked reasonably well. The theory has been that as housing grows older, it grows more capital cheap and as it grows more capital cheap, it passes on to people who are of lower income. That worked reasonably well—it missed lots of people, but it worked reasonably well until utilities enormously increased, and suddenly we moved from a situation where major cost of housing were not simply capital costs but were operating costs. Operating costs for the first time in at least 20 or 30 years suddenly became a major component and an enormous component of the cost of housing.

As that occurred, the old trickle-down theory was turned on its head. Old housing, while capital cheap, is energy expensive. Now we add to that today the fact that interest costs, once running 7, 8, and 9 percent which we assumed was the norm, suddenly moved to 15, 16, and 17 percent and the like. The result is that the trickledown theory is collapsed and the housing industry, both in terms of its capacity to respond to the needs of not just the poor anymore but moderate and upper middle income people, is utterly folding. We have not figured out how to restructure that system. The public housing system suffers exactly the same forces that are at work on the private housing system. Fundamentally, the enormous increase in cost is what you and I are experiencing in our own homes, the enormous increase in utility costs.

What that means is, as the spread between what the poor can afford and the real cost of housing greatly increases, the frustration of those of us in the business as to how to maintain financial stability greatly increases. But I believe that the place we have to look is not to try and figure out how to squeeze blood from a stone but, rather, figure how we can cover those enormous increases in utility costs.

Let me move if I can now to the three elements of my testimony.

[The complete statement follows:]

CLPHA

Council of Large Public Housing Authorities

TESTIMONY OF LEWIS H. SPENCE, COURT-APPOINTED RECEIVER OF THE BOSTON HOUSING AUTHORITY

A. INTRODUCTION

Good morning Mr. Chairman and members of the Committee. My name is Lewis H. Spence and I am the court-appointed receiver of the Boston Housing Authority. I am speaking today as a spokesman for the Council of Large Public Housing Authorities (CLPHA). The Council was formed last year in response to the unprecedented crisis provoked by the Department of Housing and Urban Development's refusal to ask the Congress for adequate funding for public housing operating subsidies. I am here today to tell you that the outlook for this year is much worse than it was last year, and the future is exceedingly grim. If public housing operating subsidies are limited to the levels currently being proposed by HUD, the Council believes that within a few years there will no longer be any public housing in this country than can provide shelter for low-income people.

My testimony today is divided into three parts.

First, I would like to respond to some questions that have been put to the Council by the staff of your Committee last week.

Second, I would like to comment on some of HUD's current actions toward public housing, particularly: a) HUD's estimates of FY82 operating subsidy needs; b) HUD's manipulation of utility consumption figures for FY82; and c) HUD's delays and proposed retroactive revisions of its own regulations.

Third, I would like to offer to the Committee some positive proposals which the Council has developed concerning improvements to the public housing Performance Funding System, and a proposed program of energy conservation.

B. Response to Questions from Staff.

The first group of questions was as follows:

1. Should the operating subsidy be capped for FY83, FY84 and FY85 at the FY82 level, if in return Congress agreed to authorize and appropriate funds for this entire three-year period?
2. If this three-year authorization and appropriation were provided to HUD, should HUD then enter into three-year contracts with Public Housing Authorities (PHAs) to provide a flat, but predictable, level of operating subsidies for each of those three years?
3. Should local PHAs be concurrently given autonomy to set local rent levels, so that they can make up in this way for any short-fall in federal subsidy by raising rents to public housing tenants.

First, Mr. Chairman, I would like to point out that no specific funding level has been proposed for the "cap." The Council believes that $1.401 billion in operating subsidies are needed in FY82. HUD is now claiming that only $1.152 billion is required. Other estimates range as high as $1.52 billion.

If the subsidy is capped at the level that HUD claims is needed in FY82, this would be totally disastrous for public housing. The Council estimates that the minimum subsidy that will be needed in FY83 will be $1.6 billion, in FY84 $1.7 billion, and in FY85 $1.8 billion. These estimates assume that tenant rents will gradually grow to 30% of tenant income, as provided in last year's Budget Reconciliation Act.

The annual short-falls that would be produced by such a cap are as follows:

($ billions)	Need	Funding	Short-fall
FY82	1.4	1.152	.248
FY83	1.6	1.152	.448
FY84	1.7	1.152	.548
FY85	1.8	1.152	.648
TOTAL SHORT-FALL, FY82-FY85:			1.892

In other words, Mr. Chairman, if a cap were adopted at the FY82 levels, approximately $1.9 billion less would be provided to Public Housing Authorities during the four-year period FY82-85 than is currently estimated as a minimum level of need under the Performance Funding System. PHAs could not survive with a short-fall in funding of this magnitude.

The average short-fall per year would be $473 million. For the 130 largest PHAs that get 80 per cent of the subsidy and manage 60 per cent of the conventional public housing units, the average subsidy short-fall would be $378 million, or $525 per unit per year. In order to compensate for this short-fall by raising rents, these PHAs would need to increase rent levels by $44 per unit per month, in addition to the rent increases already being produced by raising rent levels to 30% of tenant income. This represents approximately a 50% rent increase on top of the rent increases already in the pipeline.

Rent increases of this magnitude could only be obtained by abandoning the principle that public housing tenants should pay no more than 30% of their incomes for rent, and by eliminating income eligibility limits for public housing. In other words, you would need to begin privatizing public housing, and turn it into housing for middle-income people. The Council is opposed to this policy.

A second objection to the "cap" is that the Council has not found much support in Congress for a three-year appropriations for public housing. A "cap" in authorizations only would not provide a guaranteed level of funding for public housing, only a limit on the total subsidy available.

Finally, the proposal for a "cap" does not recognize the great volatility of the most important element of public housing operating costs: utility expenses. Mr. Chairman, oil prices alone rose by over

60 per cent on the average from 1979 to 1980. Utility costs including fuels now account for over 44% of the total cost of operating public housing, and over 50% for some PHAs. Although oil costs are relatively stable at the moment, the same is not true for other fuel costs such as gas and electricity, and even the current plateau in oil costs may not last much longer. Gas costs are expected to climb sharply in anticipation of total de-regulation by 1985. It would thus be very unreasonable to put a cap on the operating subsidy at this time, when future fuel prices are so volatile and unpredictable.

What the Council does support, in contrast to the "cap," is full funding of the current Performance Funding System, at 100% of the need determined by this formula. HUD is currently analyzing the "cost-based system," and possible alternatives to it. When HUD completes its analysis, the Council believes that this will be the best time to determine whether or not any changes are needed.

The Council recognizes that the proposal for a "cap" originated with smaller PHAs who desire a more predictable level of funding from year to year, in order that they might carry out their planning on a longer-term basis. Large PHAs, Mr. Chairman, that depend upon the operating subsidy for their survival, cannot sign away funds of this magnitude in return for funding predictability. Without the adequate funding levels that are truly needed, most of us would no longer be able to continue to operate.

The Council is also opposed to total local autonomy in setting rents and determining income eligibility levels. These proposals would in effect end the public housing program by permitting PHAs to set rent levels that could only be afforded by moderate-income people, contrary to the entire history and purpose of the public housing program in America. We see no support for such a proposal in the Congress, which has a long commitment to public housing as a program for the nation's poor.

Federal subsidies will continue to be needed to make up the difference between operating expenses and the rents poor people can afford to pay. We therefore continue to support the current calculation of rent based upon a maximum of 30% of tenant income, and a limit on tenant eligibility to 80% of SMSA median income.

In addition to the above questions, the Committee staff requested comments on the following proposals:

1) Minimum rent equal to utility costs;
2) Elimination of negative rents;
3) Counting food stamps as income for public housing purposes;
4) Eliminating all deductions from income; and
5) Allowing rent increases of up to 20% per year.

Mr. Chairman, in some public housing developments, utilities are provided separately to each unit, and are separately metered and paid for by individual households in addition to their rents. In some of these cases, particularly for very low-income tenants, the total amount paid for rent and utilities can exceed 30% of tenant income. In these cases, PHAs are authorized to make a payment to the tenant in the amount that total costs exceed 30% of income. These payments are almost always made out jointly to the tenant and the utility company, and are not available to the tenant as income. Such a payment has been characterized as a "negative rent," since it involves a payment by the PHA. No inequity is involved, since the household is still paying 30% of its income toward rent and utilities, just like other tenants.

However, to some, a payment by the Authority to the tenant appears unjustified. HUD has therefore proposed that all such "negative rents" be eliminated.

HUD has also proposed that, beginning in FY83, a minimum rent be established for all tenants, even in units where the PHA pays all the utility bills, that would equal at least the cost of the average utility bill paid by the PHA.

The Council does not have the kind of data available that would enable us to analyze the exact impacts of these proposals. We suspect that they will hit the lowest income tenants hardest, at the same time that very little additional income is produced for most PHAs.

HUD's own Office of Policy Development and Research, however, has already conducted a preliminary analysis of its own, which I am attaching to this testimony. This analysis shows, and I quote, that:

> "....this proposal would lead to substantial differentials in the depth of subsidy provided to tenants of assisted housing programs, both across regions and among tenants in a particular project or PHA. The policy will disadvantage tenants in the lowest income groups, those in high-cost utility areas, and those living in energy-inefficient buildings."

The report goes on to estimate that about 40 per cent of all Boston tenants would be required to pay 50 per cent or more of their income if the minimum rent is set at the average PHA utility charge. While these figures are apparently still open to some question, there seems to be a growing consensus within HUD itself that this scheme is ill-conceived and would hurt lowest income tenants the most. The Council is therefore opposed to this provision in its present form.

Conceivably, some form of minimum rent could be established for public housing tenants, that would still provide a reasonable degree of equity, would not hurt the lowest income tenants the most, and would not produce rents grossly in excess of 30% of tenant income. HUD's current proposals are not the way to accomplish this end.

As far as counting food stamps as income, a proposal made by HUD to commence in FY83, the Council is simply opposed to this proposal. The proposal is only one of many ways that HUD is using to try to reduce operating subsidy levels, without consideration of equity or consequences for low income tenants. To quote HUD's own memo again:

> "Counting food stamps as income most severely affects the lowest income, those with the largest families, and those who are living in areas where the value of food stamps is large relative to the level of AFDC benefits. (In some states the Federally-established food stamp benefits exceed the State-determined AFDC allotment). Meanwhile, full State implementation of the AFDC program option to count both food stamps and HUD assistance as income could result in a 60 to 65 per cent drop in AFDC benefits. It is thus conceivable that a "30 per cent of income" tenant rent charge could exceed a household's cash income. The Department will not be allowed to ignore the effects of the recent AFDC changes in setting its own rent policies; critics are already suggesting that in some Southern States HUD tenants will have to pay part of their rent with food stamps!"

The Department has clearly not studied the program inter-actions between its own proposals and the changes being made in the food stamp and AFDC programs. These proposals clearly could have disastrous consequences for individual households, and should not be adopted.

Turning now to the question of eliminating all deductions from income, our members are somewhat divided on this proposal. All of our Council members believe that the medical deduction should remain. Most of our members feel that the present system of deductions works reasonably well. However, some members feel that non-medical deductions should be more tightly controlled, if not eliminated altogether.

Finally, the Council sees no clear need to change the current law, which authorizes rent increases of up to 10% per year, by raising the limit to 20% per year. The "20% increase" provision would only be needed to enable the much larger rent increases that would result from local autonomy in rent setting, or counting food stamps as income, both of which are provisions which the Council opposes.

C. Problems with HUD's Current FY82 Operating Subsidy Estimates, Utility Consumption Adjustments, and Inordinate Funding Delays.

Mr. Chairman and members of the Committee, I would now like to review with you some of the current actions being taken by HUD that are extremely serious for our operations this year.

1. HUD's Estimates of FY82 Operating Subsidy Needs Are Unrealistically Low. The Council estimates that $1.401 billion in operating subsidies are needed for FY82 in order to fully fund the Performance Funding System (see Figure 1). Congress has already appropriated at least $1.152 billion for FY82. We therefore believe that there is currently a $249 million short-fall for FY82, and that PFS is currently funded at about 82% of the need.

Our estimates were largely based upon the PFS calculations carried out by HUD last year. Last Fall, HUD estimated the FY82 need as $1.370 billion, only $31 million lower than the Council's estimate. The major differences were that HUD saw somewhat more income being realized from tenant rent increases this year, and HUD also eliminated $17 million in additional insurance costs. (also see Figure 1.)

Since last Fall, however, HUD has discovered what it claims to be opportunities for an additional $218 million cut in the operating subsidy needed for FY82. This would reduce the need, not so coincidentally, to exactly $1.152 billion, precisely the amount already appropriated. HUD therefore now claims that no short-fall exists, and the Department will actively oppose any supplemental appropriation for FY82.

The so-called "justifications" which HUD has come up with to slash the subsidy include:

a) Mandatory utility consumption reductions by PHAs of 10%	$103.6 million
b) Mandatory paybacks in energy costs due to modernization	40.0
c) Unspecified state and local contributions	41.6
d) Unspecified cost reductions due to "de-regulation"	20.0
e) Arbitrary reduction in the non-utility inflation rate.	12.8
TOTAL CUTS	$218.0 million

Mr. Chairman, the Council believes that these proposed reductions are the figments of HUD's imagination, and have no basis in reality. Senator Garn has already written to the Department calling upon HUD to give up its plans to require utility consumption reductions across the board by PHAs. We have not seen any information which HUD has available to justify these calculations. When asked by the House to justify these estimates, HUD asserted that the impacts could not be calculated until they actually occurred! The mandatory utility consumption reductions are irresponsible. In addition, the $40 million in state and local funds supposed to be made available to PHAs from state and local sources is only the "residual," i.e. the gap that HUD could fill by no other means. For FY83, this "residual" attributable to state and local sources is projected by HUD to grow to over $90 million. In neither year does HUD say where these funds are supposed to come from, and the Council believes that in fact there is no source.

HUD is playing an irresponsible game with PHA budgets, over 5 months after the federal fiscal year has begun, and three months after the budget years for most of the largest PHAs have commenced. Mr. Chairman, this is an intolerable situation, deeply detrimental to the effective administration of the public housing program.

No PHAs have yet received any of this FY82 money in hand. The PHAs which began their Fiscal Years on January 1, 1982, a group which includes most of the largest PHAs and which ultimately receives an average of forty per cent of the operating subsidy each year, are now into their fourth month of operations without an approved budget from HUD! Much worse, when these budgets are approved by HUD, they will be approved at a level of only 75% of the acknowledged need during FY81, not including utility adjustments. This represents only approximately 60% of what these PHAs need in FY82. HUD plays with the allocation of these funds while a disastrous situation has been created for these Authorities.

The reason that these funds are being held back is that since HUD has created so many arbitrary reductions in the amount of money it now claims is needed for FY82, HUD now has no formula it can use to allocate the funds in FY82. These formulas are expected to take months more to develop, if indeed they can be achieved at all during the present Fiscal Year.

Mr. Chairman, we ask your help in trying to prevent HUD from making a mockery of the Performance Funding System in this way. The statistical outputs of this system are intended to indicate the reasonable costs that are required to operate public housing. HUD is taking these outputs and chopping them down to fit the Procrustean Bed of its own politically-determined budget estimates. It is an exercise in futility for HUD to carry out its own internal evaluation of the Performance Funding System if the outputs are to be so completely distorted in this way.

2. Mandatory Utility Consumption Reductions for FY82. As pointed out above, HUD intends to mandate utility consumption reductions by PHAs during FY82 that will save HUD $143.6 million in operating subsidy funds this year. HUD has recently issued a memo to its Regional Offices describing how these mandatory reductions are to be achieved. I am attaching a copy of this memo to my testimony. In essence, the Regional Offices are being told to calculate reductions in private market energy consumption in their areas since 1976, and apply these reductions to Public Housing Authorities. Our criticisms of this methodology include the following comments.

- private market housing in general cannot be compared to public housing in this simplistic way, because of differences in the characteristics of the stock, such as age, physical characteristics, unit sizes, condition, deterioration, etc.
- the data even for private market units is not reliable and readily available.
- the proposal penalizes PHAs that made extra efforts to conserve energy prior to 1976, since their consumption levels will be reduced based upon 1976-81 private market trends.
- HUD controls the means by which PHAs can reduce consumption, namely through modernization funding, and the mandatory consumption reductions do not take modernization funding into account, except for the additional reductions mandated wherever "energy-related" modernization has been done.
- for PHAs that have done better than the private market at energy conservation, their incentive to conserve further will be removed, since their consumption level is reduced to the prior year's level, not simply to the private market average.
- HUD has already determined what the consumption reduction is going to be, in order to meet HUD's need to reduce operating subsidy. If the Regional Office's calculations don't fit the range pre-determined by HUD Central, the assumption is that the calculations are wrong, and a minimum 5% reduction will be used.
- The adjustment factor will be applied to new projects as well as

to old ones. It is illogical to apply consumption reductions based on the period 1976-81 to projects that may be only a few years old. In addition, newer projects were probably built to more energy-conserving standards, and therefore don't have as much potential for further energy savings as older projects.

- New Comprehensive Modernization (CIAP) projects have not been in place long enough to have their paybacks determined.

- The proposed procedures will effectively eliminate all incentives for energy conservation.

- The 50/50 share in energy conservation savings currently allowed to PHAs will be subject to "availability of appropriation" and will probably be entirely eliminated in FY82. This totally eliminates all incentive to energy conservation. PHAs will be in trouble in years with cold heating seasons, and won't be able to recoup their losses in years with mild heating seasons. They will therefore be increasingly squeezed.

- Water and sewer expenditures have been inexpicably lumped together with fuel costs, and reductions mandated for these, too, although they have nothing to do with energy conservation.

- One single factor will be applied to the PHA, to calculate its mandatory reduction in energy consumption, regardless of its fuel mix. If the PHA's fuel mix is not the same as the fuel mix for the private market housing in the region, there may be serious inequities in the factor applied.

- Conversion of all fuels into a BTU figure, for purposes of calculating this per cent reduction factor, is almost impossible to do because of the different energy efficiency factors of various fuels, especially electricity. There should at least be separate factors for each fuel type.

- Requiring the FY81 figure to be used in all cases where it is the lowest is inequitable. It doesn't allow for Heating Degree Days. If there was a mild winter that year, PHAs would be unfairly held to the same level in subsequent years.

- The procedure results in double-counting savings that theoretically are produced by modernization expenditures.

It is obviously absurd for HUD to continue to try to implement these proposals, which will totally eliminate any energy conservation incentives currently built into the existing Performance Funding System. This is entirely contrary to the intent of Congress.

As you know, Senator Garn has written to HUD requesting that HUD not proceed with its intentions to implement these changes. Nevertheless, HUD continues to proceed along these lines, as evidenced by the memorandum sent out to the Regional Offices over 10 days ago.

The Council would therefore like to appeal to your Committee to take immediate action to mandate that HUD not proceed with the implementation of these changes, and that, instead, HUD be required to fully allocate the FY82 funds already available to it, without further delays.

3. Delays and mis-use in allocation of FY81 funds. HUD is still delaying the allocation of the FY81 supplemental appropriation provided by Congress last year. The Department has announced its intention not to pay utility adjustments out of FY82 appropriations. This would hold back as much as $65 million in funds which PHAs would normally be entitled to in FY82. HUD is refusing to allocate FY81 supplemental funds until PHAs agree that they will claim no further utility adjustments funds for FY81. Our Council has advised PHAs to sign-off on the provision with an indication that they are not thereby foregoing their legal rights to pursue further legal action on this matter against the Department. Such a law suit is currently being explored by Council members.

4. Proposed Central Office Review of FY82 Budgets. As if all of the above actions by HUD did not create problems enough, the Department has additionally announced its intention to review the FY82 budgets of the 50 largest PHAs in the Central Office, thereby further seriously adding to further delays. The Department has hinted that it

is developing additional cost standards for such PHAs, although these would be contrary to the standards already in place under the Performance Funding System.

Mr. Chairman, this Committee has undoubtedly heard HUD repeatedly complain of local PHA waste and mismanagement. But the greatest problems for PHAs are created by this type of unpredictable behavior on the part of HUD. Local PHAs cannot manage public housing when HUD withholds available funds, and will not tell them how much they can expect to receive during the year, or when HUD carries out a program of systematic harrassment of PHAs through a variety of administrative obstacles and delays. It is time for HUD to get its own house in order.

We are obviously also seriously concerned that adequate funding provided for operating subsidies in FY82, and believe that a truly realistic estimate o. the current short-fall is approximately $249 million.

FIGURE 1

ESTIMATED NEED FOR FY82 PUBLIC HOUSING OPERATING SUBSIDY.

($ millions)

	HUD Est.	CLPHA* Est.
Allowable Expense Level (AEL)	1469	1469
Utilities	1104	1104
IPA (audit)	4	5
Income, with no change in rent-income ratios	(1221)	(1221)
PFS BASE	1356	1357
Increased rent-income-ratios		
- All tenants to 26%	(25)	(15)
- New tenants to 30%	(8)	(5)
Insurance costs	0	17
Non-PFS Authorities	47	47
TOTAL	1370	1401

Miscellaneous recent adjustments by HUD

- Reduction in utility consumption base by 10%	(103.6)
- Payback from energy modernization funding	(40.0)
- State and local government contributions	(41.6)
- Cost reductions due to de-regulation	(20.0)
- Reductions in non-utility inflation rate to 7.5%	(12.8)
SUB-TOTAL NEW ADJUSTMENTS	(218.0)
TOTAL NEED ACCORDING TO HUD	$1152

*Council of Large Public Housing Authorities

D. Proposals from the Council of Large Public Housing Authorities.

I would now like to turn to some specific, positive proposals of our own which the Council of Large Public Housing Authorities would like to make for improving the administration of the public housing program.

1. Improvements in the Performance Funding System. The Council has developed a set of recommendations for improving the Performance Funding System. The following Draft recommendations were developed at the Council's meeting in Boston in January. These recommendations are currently being reviewed by Council members. I anticipate few substantial changes. The recommendations are covered in detail in an attachment to this testimony, and are summarized below.

- improved management incentives;
- PFS adjustments including annual inflation adjustments;
- energy-related improvements to PFS;
- an appeals process;
- consideration of distinctions among categories of PHAs;
- simplification of PFS work-sheets; and,
- relationship of modernization and development funds to the operating subsidy.

The Council's priorities are the first two items above. I would also like to point out that the fifth item, "consideration of distinctions among categories of PHAs", includes consideration of further "range tests" for PHAs in each of a variety of different categories. We understand that Abt Associates Inc. is now doing further research on how these "range tests" might be established.

2. Recommended Program of Energy Conservation in Public Housing. In addition to the proposed improvements in the Performance Funding System, and closely linked to these improvements, we propose a positive program for energy conservation in public housing. This program is comprehensive. We believe it can work.

Our program includes the following components:

- maintaining the energy conservation incentives now built into the Performance Funding System.
- providing adequate modernization funds for energy conservation;
- adopting a fair procedure for calculating the utility consumption base;
- allowing PHAs to establish energy conservation reserve funds to draw upon to make conservation-related capital improvements and leverage private funding for such improvements;
- greater HUD action in assessing its own data, identifying PHAs with high average consumption, establishing fair allowable consumption levels, targeting PHAs for energy audits, and following up to determine what physical and management steps need to be taken to correct problem situations, and what resources are needed for these activities;
- a more significant program of HUD research into ways that PHAs can reduce energy costs, including publication and distribution of this information and follow-up with technical assistance.

An attachment to this testimony includes a brief additional statement elaborating on each of these items.

E. CONCLUSION

Mr. Chairman and members of the Committee, thank you for your attention. In closing, I would like to quote from the findings of a recent report prepared by the Surveys and Investigations Team of the House Appropriations Committee. The report concludes with the following paragraph:

> "Public housing is a program for the needy. Unfortunately, many PHAs are confronted with tenants subject to severe poverty, unemployment, vandalism and crime. These factors make the administration of the program difficult and the operation very costly. The Investigative Staff believes that the objective and character of the program must constantly be kept in focus. Public housing accounts for 1.5 per cent of the 81 million units in America but furnishes what the private sector cannot -- decent housing for over 3 million needy people."

I believe than in the positive recommendations we have made above, the Council has demonstrated its commitment to finding ways to improving the management of public housing in this country. HUD needs to be moved to show the same kind of commitment to expeditious action without further delay.

We know that your Committee is seriously considering a program of mortgage assistance for home buyers that cannot afford today's housing prices. Such a program would help to stimulate the seriously depressed housing construction industry.

We hope that you will also consider the needs of the nation's low-income households, which can only be served through subsidized programs such as public housing.

Thank you Mr. Chairman.

ATTACHMENT I: DETAILED RECOMMENDATIONS FOR IMPROVING THE PERFORMANCE FUNDING SYSTEM.

Introduction

The Council of Large Public Housing Authorities (CLPHA) supports a fully-funded Performance Funding System (PFS) in a revised and improved form as the principal funding mechanism for the nation's conventional public housing program.

Until a better system can be designed, and its impact evaluated, PFS represents the best currently available system that attempts to reflect the true cost of operating public housing, while retaining the principal purpose of public housing: to provide housing for the poor.

CLPHA believes that with the following revisions and improvements, a fully-funded PFS can adequately support the operations of PHAs and the tenants they serve.

CLPHA is also aware that a variety of revisions and alternatives to PFS are now under study by HUD, and CLPHA will review these recommendations when they become available to determine what position to take in the future.

CLPHA's priorities are recommendations #1 and #2 below.

1. Management Improvements and Management Incentives

a) Allow PHAs to keep some portion of increases in budgeted income. At the present time, if a PHA can budget an increase in its income for any reason, from one year to the next, its subsidy will be reduced by the same amount. Therefore, there is currently no incentive for the PHA to try to increase its income.

CLPHA believes that there should be some system whereby PHAs are allowed to keep some of this increase in income. Mr. Ray Struyk has made what appears to be one type of effective proposal for accomplishing this end. The Struyk proposal would allow a PHA to deduct only 85% of any increase in income from the amount of subsidy received. This would have a cumulative effect over the years, as the budgeted income for PFS calculations would increasingly grow smaller than actual PHA income. Struyk proposes a limit on the savings at the point where budgeted income has been reduced to 80% of actual PHA income. It would take a number of years, however, before a PHA would actually reach that point.

In order to insure that these funds were used for the PHAs highest priorities, it would be possible to consider mandating that the funds be put into a capital improvements or energy conservation reserve fund, provided that doing so did not result in the PHA's losing its modernization funding to a comparable degree.

b) Vacant units. Allow PHAs to keep all rental income that is collected above an established occupancy rate, e.g. 95%, in current and subsequent years, in order to provide an incentive for lowering the vacancy rate.

c) Ceiling rents. Continue to permit PHAs to establish ceiling rents. In many PHAs, ceiling rents are needed to maintain an exonomic mix of tenants within public housing. Depending on the local private market, the elimination of ceiling rents could drive out more moderate income tenants from public housing. This would cause more dependence of the PHA on the Federal operating subsidy. More attention needs to be paid by PHAs, however, to adjustments in ceiling rents so that they do not lag far behind comparable private market rent increases.

d) Reserves. Reserves are now widely misunderstood as being merely a "cushion" for PHAs, producing interest income to PHAs while adding to the drain on the federal subsidy. In the interests of good management, however, some type of capital improvements reserve for major repairs and replacements is absolutely essential for any well-run real estate operation. PHAs should be allowed to budget an adequate level of annual payments into such reserve funds.

Consideration might also be given to establishing a reserve fund specifically for energy conservation capital improvements. PHAs could be allowed to keep 100% of their increases in income provided that the funds were deposited in this energy conservation reserve account. This same principal could be extended to allow PHAs to keep 100% of the savings realized by reductions in consumption below the utility "base", provided that these savings all went into the energy conservation reserve. For

PHAs in the enviable position of having reach the "maximum reserves" position, they could be allowed to exceed the maximum reserve provided that these funds were targeted to energy improvements and expended within a reasonable time period.

The reserve fund could also be used to leverage additional private investments in public housing energy improvements.

e) Interest income. Eliminate the HUD requirement that PHAs return a portion of their interest earnings to HUD if these earnings exceed HUD's current limits.

2. Adjustments to PFS Formula (including inflation adjustment).

The Allowable Expense Level (AEL) should be adjusted at the end of each Fiscal Year for inflation as is done now with the utilities expense level, to reflect the change between the originally projected inflation rate and the actual inflation rate.

Rather than using the wage-scale index to determine the AEL inflation rate (since wages have been depressed over the past few years compared to other prices), a truer indication of inflation for PHAs would be a composite inflation factor weighted for building materials, insurance costs, employee benefits and the other elements that make up the AEL. This would tend to reduce the type of underestimation of AEL inflation rates that has occurred in past years.

CLPHA agrees with the concept of a retrospective inflation adjustment to make up for underestimation of inflation for previous years.

CLPHA is willing to explore the concept of a two or three year authorization by HUD of a local PHA's AEL, in order to promote better planning and management within the PHA. The second and third year AEL would be calculated by applying the inflation factor to the previous year's AEL as an adjustment. The authorization established by HUD for each PHA would be "subject to available funding" by Congress, and HUD would still have to seek funding for the public housing operating subsidy on an annual basis. CLPHA is opposed to any "cap" on authorizations for the public housing operating subsidy at the FY82 level.

CLPHA also feels that a one-time adjustment should be made to the AEL for those PHAs which were most adversely affected by inadequate base-year funding, either by direct action by HUD or through an appeals process if one were established.

3. Energy-conservation related improvements.

CLPHA strongly supports maintaining year-end utility adjustments, where the prices of utilities have gone up at a more rapid rate than was projected in the utility budget. HUD is now trying to eliminate such adjustments in the FY82 budget, contrary to regulations.

The year-end utility adjustments should be calculated taking degree-days into account.

CLPHA supports maintaining at least the current 50/50 formula whereby a PHA is allowed to retain half the savings it realizes in energy consumption. In addition, CLPHA recommends that PHAs be allowed to retain an even higher proportion if these savings are deposited in an energy conservation reserve account, to be used for energy conservation related capital improvements. This incentive should be strengthened, not weakened by HUD.

Additional energy issues are related to modernization (see Section 7).

4. Appeals Process.

CLPHA supports the concept of an appeals process whereby PHAs can attempt to obtain compensation for what they feel is inadequate funding, either due to inadequate base-year funding or because of costs incurred by the PHA that are not reflected in the current PFS formula, e.g. crime, vandalism, etc. These costs are often associated with the larger urban housing authorities.

There should be strict guidelines for such an appeals process so that only essential appeals would be heard and so that the process would not become totally politicized. Some of the elements of an appeals process could include the following:

- limit of one appeals per PHA every three years;
- rigid time guidelines on determining appeals;
- limit on the amount that could be awarded through the appeals process, per PHA; and,
- have a PHA representative and a professional arbitrator on the Appeals Board.

5. Distinctions among Authorities.

A number of distinctions among PHAs are already factored into the PFS formula. CLPHA is interested in exploring with Congress, HUD and other groups the possibilities of introducing further distinctions into the funding system that would reflect the different approaches appropriate to large, medium, small and troubled PHAs.

One possibility might be to introduce further "range tests" into the formula, for each category of PHA.

Troubled authorities should be dealt with through an appeals process and through MOD and CIAP funding, with funding contingent upon the PHA's improved management capability.

6. Simplifying PFS worksheets.

The "Delta" factor used in calculating the annual subsidy level (per unit month) is intended to reflect the changing circumstances of the PHA. Most of the statistical variables used in calculating "Delta" are actually surrogates for real conditions at the PHA.

(For example, "size of SMSA" is a surrogate for problems associated with large urban PHAs.)

The "Delta" factor is complex to calculate and in practice has little net effect on the change in subsidy level from one year to the next. It is proposed that the "Delta" factor be eliminated at the present time and perhaps be brought back later in a way that is more closely related to actual, significant changes in the PHA's status.

7. Modernization and development funds.

CLPHA recommends that modernization funds not be rolled in with operating subsidy funds, but be retained as a separate entity.

Full and adequate funding of the modernization program is imperative.

CLPHA agrees that the CIAP permits emphasis on energy conservation, but feels that the modernization money currently available is insufficient to support as significant a level of energy conservation improvements as is needed and justified by their potential paybacks. Timely use of modernization funds can save operating expenses in the future, and thereby reduce future dependency on the federal subsidy.

The bulk of the modernization program money should be channeled through CIAP, but HUD should allow a small proportion (reserved for small jobs) to be treated in a flexible fashion by the PHA.

The development program should also be retained, and there should be increased flexibility for PHAs to use previously committed but unused development funds for modernization without returning 50% or more of these funds to HUD as a condition of the transfer.

Attachment II: An Energy Conservation Program for Public Housing.

1) Maintain energy conservation incentives now built into the Performance Funding System.

   a) Maintain the 50% share of savings from conservation that PHAs are now allowed to keep; and (also see below) add a new provision that PHAs may be allowed to keep 100% of the savings if they earmark these funds and put them into an energy conservation reserve funds, as long as there are clearly identifiable additional energy conservation measures for which these funds will be expended within a reasonable time.

   b) Maintain the system of end-of-the-year utility adjustments now contained in HUDs's own regulations,

2) Adequate modernization funds, tied in with energy conservation planning.

   We have supported this Committee's recommendations to adequately fund the modernization program. It is not yet clear how HUD will monitor the modernization program to identify what expenditures are being made for energy conservation purposes, but HUD should explore possible avenues for providing incentives for using the money in this way.

3) Adoption of a fair utility consumption base for PHAs.

   Instead of picking private market numbers out of the air, and trying to use them as a basis for establishing allowable consumption levels in public housing -- which is unfair because the public housing stock has entirely different characteristics -- HUD should do its own studies of current PHA utility consumption rates, analyze the reasons for variations among buildings and PHAs, come up with a reasonable consumption ceiling. It should be recognized that many PHAs are unable to bring consumption down to this ceiling without additional modernization spending.

   A less normative alternative that could be explored would be to determine the allowable utility consumption base by calculating the average consumption level over the five preceding years for each PHA. If a PHA were conserving energy, its consumption base would gradually decline, but it would still be allowed to keep some of the savings it was producing.

4) Energy conervation reserve fund.

   Permit PHAs to keep an additional share of any increases in income they achieve through a variety of means, including reduced energy consumption, provided that these funds are put into an energy conservation reserve fund and earmarked for further future energy conservation improvements, including "leveraging" private investments in such improvements.

5) HUD management, monitoring and audits

HUD should exercise closer managerial scrutiny of PHA energy consumption, collect and analyze consumption data, identify those PHAs with apparently high consumption and develop a program for addressing problem projects or PHAs, through a combination of modernization funds, management improvements, energy audits, and other "work-outs."

6) More research

Expanded program of HUD reearch into ways that PHAs can reduce energy costs, and publicizing, distributing and following up on these cases, along with technical assistance to PHAs.

Attachment III.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR POLICY DEVELOPMENT AND RESEARCH

FEB 24 1982

FROM: E. S. Savas

SUBJECT: Tenant impacts of recent policy changes

During final negotiations on HUD's FY 1983 budget, the Department agreed that the minimum contribution by tenants assisted under the housing subsidy programs would be increased to an amount at least equal to the estimated cost of all utilities. This program modification results from widespread concern over so-called "negative rents." "Negative rent" is a term used to describe situtations which occur in HUD-assisted housing when tenants are directly billed for some or all utilities and their utility allowance exceeds their percentage-of-income rent charge. Under the voucher program, for instance, the minimum tenant contribution would be set at the higher of 30 percent of adjusted income or 10 percent of the tenant's gross income. If utilities for the tenant's unit are separately metered and the utility allowance (estimated utility cost) for the unit exceeds the minimum tenant contribution, the following occurs: the tenant pays no rent to the landlord, pays all of the cost of the separately metered utilities, and receives a check back to cover the estimated amount by which utilities exceed the tenant's required rent contribution. The term "zero rent" rather than "negative rent" would be more descriptive of the fact that the few tenants caught in these circumstances are paying no rent to the landlords. In actuality, negative rent cannot exist under current rules if utilities are considered to be a legitimate part of housing costs.

When the proposal was first made within the Department to eliminate "negative rents," OGC was concerned that such a rule would be difficult to defend on grounds of equity, since for two tenants using the same amount of utilities in the same PHA, but residing in projects with and without individual metering, respectively, one tenant would be subject to potentially large increases in rent while the other would be totally unaffected. An attempt was made to produce "rough equity" by proposing that the minimum assisted housing tenant rent contribution would be at least equal to the total estimated utility cost for a unit, whether those utilities are paid by the landlord or directly by the tenant to the utility company. Leaving aside the enormous administrative burden which this change could impose on PHAs (separate utility schedules for apartments facing north? hearings for disgruntled tenants who are frugal in their use of utilities?), there are more fundamental issues associated with the proposed change. Our analysis indicates that this proposal would lead to substantial differentials in the depth of subsidy provided to tenants of assisted housing programs, both across regions and among tenants in a particular project or PHA. The policy will disadvantage tenants in the lowest income groups, those in high-cost utility areas, and those living in energy-inefficient buildings.

The attached tables show that some families could be required to to pay in excess of 50 percent of their adjusted income to live in HUD-assisted housing. In Boston, for instance, 68 percent of all tenants would be required to pay a rent higher than that mandated after the 1981 rent increases have been fully implemented. About 40 percent of all Boston tenants would be required to pay 50 percent or more of their income if the minimum rent is set at the average PHA utility charge. Boston and a few others like it are extreme cases, since for many PHAs, especially those with mild climates, the impact would be negligible. The point is that "Bostons" do exist, and that this type of impact was not the intent of the proposal and is not likely to be well-received in Congress.

At the same time that these inequities across regions and tenant income levels are being produced, two other sets of policy changes now underway could have equally significant impacts. One is the proposal to permit HUD to count food stamps as income for HUD rent calculations, and the other is a recent legislative change which gives States the option of counting HUD assistance and food stamps as duplicative of the food and shelter portions of the AFDC grant. Counting food stamps as income most severely affects the lowest income, those with largest families, and those who are living in areas where the value of food stamps is large relative to the level of AFDC benefits. (In some States, the Federally-established food stamp benefits exceed the State-determined AFDC allotment). Meanwhile, full State implementation of the AFDC program option to count both food stamps and HUD assistance as income could result in a 60 to 65 percent drop in AFDC benefits. It is thus conceivable that a "30 percent of income" tenant rent charge could exceed a household's cash income. The Department will not be allowed to ignore the effects of the recent AFDC changes in setting its own rent policies; critics are already suggesting that in some Southern States HUD tenants will have to pay part of their rent with food stamps!

We recommend two courses of action at this time. First, we believe that it would be appropriate to consider reopening with OMB the issue of sending checks to tenants for excess utility costs. The negative rent issue was of doubtful significance and, in any event, affected only a small percentage of tenants. The proposed cure is much worse than the malady it was designed to correct, and will produce extreme situations which will be difficult to defend in Congress. Second, we believe that OGC, Housing, and PD&R should begin a structured discussion of the interaction of proposed Federal agency changes with respect to tenants served under HUD subsidy programs. Proposals to count food stamps as income under AFDC programs as well as other program changes could have unintended and, from the point of view of the households affected, disastrous consequences unless a greater degree of Federal oversight is exercised at this time.

The long-term outcome of a failure to face these problems squarely may be to undermine the credibility of the Administration's overall "Federalism" initiative. Use of exceptional "extremes" by opponents could have detrimental effects far beyond the effects of compromises necessary to ameliorate the problems raised by these proposals. If you are to take action in this direction, we need to move quickly.

Percentage of Adjusted Income
Required for Rent in the Public Housing Program
Program If the Minimum Rent Rule Includes Utilities

Adjusted Income:	$1500	$2500	$3500	$5000	$7000
PHA:					
Atlanta	60%	36%	30%	30%	30%
Boston	118%	71%	51%	35%	30%
Buffalo	58%	35%	30%	30%	30%
Columbus	41%	30%	30%	30%	30%
Dallas	34%	30%	30%	30%	30%
Denver	41%	30%	30%	30%	30%
Hartford	87%	52%	37%	30%	30%
Louisville	49%	30%	30%	30%	30%
Peoria	45%	30%	30%	30%	30%
Phoenix	37%	30%	30%	30%	30%
St. Louis	55%	33%	30%	30%	30%
Salt Lake	30%	30%	30%	30%	30%
San Antonio	30%	30%	30%	30%	30%

SOURCE: 1980-81 utility consumption data.

PD&R
2/22/82

Impacts on Public Housing Tenants of Establishing Utilities as an Additional Minimum Rent Criterion

(1980-1981 Data)

PHA	1980-1981 Average Tenant Income*	Average Actual Rent	Estimated Average Tenant Rent Under 1981 Rules	Average Monthly Utilities**	Break-Even Adjusted Income***	Percent Tenants Affected by Utility Rule
Northeast						
Boston	5480	89.00	125.00	147.48	5900	68%
Buffalo	5520	90.00	126.00	71.88	2875	14%
Hartford	5340	87.00	121.00	109.11	4365	50%
New York	8780	143.00	207.00	106.80	4270	30%
South						
Atlanta	3310	54.00	70.00	75.29	3010	60%
Dallas	3130	51.00	66.00	42.19	1690	17%
Louisville	3380	55.00	72.00	61.44	2460	40%
San Antonio	4110	67.00	90.00	37.54	1500	5%
North Central						
Columbus	3805	62.00	83.00	51.18	2045	16%
Detroit	4910	80.00	110.00	82.34	3295	33%
Peoria	3870	63.00	84.00	56.82	2275	20%
St. Louis	4600	75.00	103.00	68.27	2730	21%
West						
Denver	4170	68.00	92.00	50.88	2035	11%
Los Angeles	6380	104.00	147.00	24.73	990	0%
Phoenix	3680	60.00	80.00	46.12	1845	13%
Salt Lake City	4110	67.00	90.00	20.59	825	1%

* Median incomes are generally significantly less.

** This amount includes only PHA-paid utilities, which covers most utility costs for most tenants. Omission of tenant-paid utilities, however, understates actual utility cost.

** 30% of adjust income equals utility charge.

ATTACMENT IV

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING – FEDERAL HOUSING COMMISSIONER

MAR 1[illegible] 1982

MEMORANDUM FOR: All Regional Administrators
All Regional and Area Directors of Housing
All Field Office Managers and Supervisors

FROM: Philip Abrams, General Deputy Assistant Secretary - Deputy Federal Housing Commissioner, H Y.G.

SUBJECT: Adjustment to the performance funding system (PFS) allowable utilities consumption levels

On February 9, 1982, you were notified of certain policy and procedural changes the Department was considering regarding the Federal fiscal year (FY) 1982 budget. One of the changes mentioned was a mandatory adjustment to the allowable utilities consumption levels (AUCL) used to compute the PFS operating subsidy eligibility for the public housing agency (PHA)-owned rental housing program. It has now been determined that a reduction in the AUCL is not only appropriate, it is a necessary action to assure that the aggregate PFS operating subsidy eligibility for Federal fiscal year 1982 does not exceed the appropriation available to HUD. Also, it is the Department's position that a PHA should be required to conserve energy in amounts comparable to the savings achieved in private housing in the area in which the PHA is located.

The goal to conserve utilities in the public housing program is in line with the direction given to the Department in the Supplemental Appropriations and Rescission Act, 1981, which states:

> "While in some cases increases in consumption of utilities are justifiable, the Committee believes that every possible incentive for conservation must be utilized. Therefore, a provision has been included in the appropriation language which gives the Secretary discretion to reduce payments to housing authorities that have not added units or demonstrated reductions in fuel consumption.
>
> The Committee also believes that the three-year base period and the thirty-year 'heating degree day' average may not be an efficient way to compensate for PHA utility expenses because it may reward excess consumption and does not provide a sufficiently strong incentive to conserve energy sources. The Committee strongly opposes the payment of federal funds to PHAs that have not demonstrated reductions in fuel

consumption. The Committee believes that the Department should make some basic changes in the PFS formula to compensate PHAs on a basis which gives greater emphasis to energy conservation. The Committee will monitor carefully the Department's implementation of this appropriation language and the directives contained in this report."

In addition, since the inception of the Modernization Program, and to a greater degree in the latter years of the program, a significant amount of the funds available have been approved for work items related to energy conservation. The Department has, for some time, considered that the reduction in utilities consumption resulting from improvements made to the physical property of the projects should also be reflected as a reduction in the AUCL. To accomplish this, we propose to require PHAs, with field office oversight, to identify the amount of modernization funds spent on energy related items and to reduce their AUCLs by the estimated annual utility consumption savings.

To accomplish the above objectives, the AUCL for PHA fiscal years beginning January 1, 1982, April 1, 1982, July 1, 1982 and October 1, 1982 shall be revised to take into consideration the two adjustments discussed. Guidelines to implement the adjustments are set forth below.

1. Consumption allowed under the allowable utilities expense level must be reduced by a factor reflecting reduction of energy consumption in each state. Regional Administrators will determine the reduction factors to be applied by consulting with the Department of Energy, local/state energy offices, utility companies or other sources.

    a. The utilities to be included are electricity, gas, water, sewer and fuel, including all energy sources used for space heating and cooling.

    b. The adjustment factor will be one aggregate factor for all of the utilities mentioned in a, above, and would be developed so as to reflect a composite of multifamily and single family residential units.

    c. The adjustment factor should be developed by comparing the level of consumption during calendar year 1976 to the consumption data available for the latest calendar year, preferably calendar year 1981. (PHA fiscal years ending 3/31, 6/30, 9/30 and 12/31/81.)

    d. If a state-wide average or index is available covering the above period it could be used as the adjustment factor. If this is not available, it may be necessary to develop a composite figure for the state using local data. If this is done, the data used should be weighted by population.

e. The heating degree days experienced in the two years to be compared should be considered in arriving at the adjustment factor, if possible.

f. No adjustment factor shall be less than 5 percent nor greater than 15 percent and shall always be a reduction of consumption. (Our view is that any adjustment factor outside this range might not be a reliable indicator of the efforts made in the private sector to conserve energy.)

g. The adjustment factor will be used to reduce the Fixed Base Period AUCL of each PHA utility. This reduction would be applicable to projects classified in the PFS regulations both as "old" and "new."

2. The AUCL will be further reduced to reflect a payback on all modernization/CIAP funds used for energy conservation.

a. The modernization programs to be considered will be those that were approved in Federal Fiscal Year 1976 and thereafter.

b. The required reduction to the AUCL will be based only on the modernization funds spent on energy conservation work items.

c. The average amount that will be used to establish the annual payback percentage is 14.8. (A recent survey conducted under a contract with HUD's Office of Policy Development and Research determined that the average payback period was from six to seven years. The payback percentage is computed on this basis.) This percentage would be applied to the energy related modernization funds spent in order to determine the amount that is to be used to reduce the utility component of the PFS operating subsidy calculation, unless the PHA wishes to compute each individual payback amount based on the number of years it will take to recover its costs.

d. The payback amount, once determined, shall be applied to the utilities consumption levels by reducing the AUCLs of each utility by the percentage derived from the ratio of the annual payback amount to the 1981 actual total utilities expense. For example:

$$\frac{\text{Annual payback @ \$50,000}}{\text{1981 actual total utilities expense @ \$2,000,000}} = 2.5\%$$

The computed percentage of 2.5 would be used as an additional reduction to the Fixed Base Period AUCLs.

3. The actual adjustment to be made will be the lower level of consumption computed under the following two methods:

(i) the consumption levels of the Fixed Base Period reduced by the adjustment factor and the modernization program impact on energy conservation, as discussed above under items 1 and 2.

(ii) The actual consumption level experienced in the PHA fiscal year ending in calendar year 1981.

a. The adjusted consumption for each utility would be the lower level of the above two calculations.

b. There is a possibility that there could be duplication in the reductions required by items 1 and 2. It is reasonable to assume that at least some undetermined portion of the private sector consumption reduction was the result of energy saving capital improvements (e.g. installation of insulation, storm windows and doors). If the Regional Administrator makes a determination based upon appropriate documentation that the reduction required by item 1 already includes some portion of the consumption reductions brought about through the energy conservation efforts of the modernization activity, an adjustment of the overall percentage may be made on this basis.

c. It is anticipated that the current PFS utilities consumption adjustment (50-50) will applied against the revised AUCL, but only if funding to do so is available within the existing appropriation.

d. The above calculation is not a mandatory adjustment to be made to tenant purchased utility allowances; however, it is suggested that the Field Offices discuss this policy with PHAs that have tenant purchased utilities and suggest that similar downward adjustments in the allowances be considered.

e. The Offices of Indian Housing shall utilize the reduction factors developed for each state within their jurisdiction.

Regional Offices shall proceed immediately to assemble information and make determinations pursuant to this memorandum. PHAs should be informed of the determinations as soon as possible, instructed as to the application of the AUCL reduction factors, and advised that, upon receipt of the Handbook revision incorporating updated PFS formula and inflation factors, budgets and PFS documentation for FY 1982 may be submitted.

In their administration of this budget instruction, Regional Offices shall submit for Headquarters information, within 30-days, the following:

1. The reduction factor developed for each state.
2. For non-Indian PHAs under the PFS, estimates of subsidy savings for each field office, state, and for the region, in total, derived from each of the computations made pursuant to Items 1, 2 and 3, above.
3. Comparable figures for Indian Housing programs.
4. Documentation serving as the basis for any reduction made pursuant to Item 3b.
5. Copies of any written instructions provided to PHAs.

This reporting requirement has been cleared in accordance with Handbook 2400.3. The RMS No. is MM1122003535.

Senator **Lugar**. Thank you very much, Mr. Spence.

Obviously, all of your statement will be a part of the record and we deeply appreciate the detailed fashion in which you have analyzed each of the questions that the committee staff has raised as well as your own positive proposals.

I would like to raise these questions for both of you, and you may both want to comment or leave them alone, as the case may be.

The current performance funding system which is the basis for granting subsidies has been criticized for not encouraging cost containment or full rent collection as part of that.

Do you agree and what aspects of the formula cause this?

RENTAL INCOME

Mr. **Spence**. Actually, the PFS requires that housing authorities increase their rental income each year by at least 3 percent. If they fail to do so they are penalized. So there is that incentive, and I believe if you look across the Nation you'll find actually rent collections are remarkably strong in this housing program, in some measure let me say, because rent is related to income, and I think if you increase substantially the proportion of income for rent, the rent collections will drastically go down.

For example, at the Boston Housing Authority, we collect now roughly 98 percent of our rent roll each month. That's better than just about any landlord or utility company, certainly those collecting from the poor. I think that's a combination of sound management practices and the fact that the housing is affordable income.

I do think it may be possible to improve incentives for collections and I do think that the PFS should be looked at in order to improve incentives for rent collections. There are ways in which sharing in any increases in income could be accomplished.

But let me point out that at the moment it's hard to propose those when, for example, HUD recently urged all authorities to improve their investment practices with respect to modernization dollars that they're holding pending expenditure, many authorities then did focus in this area and increased their interest incomes substantially this year.

The large housing authorities such as New York, Chicago, and others, have just been informed that all of that interest income will be taken away this year. Last year they were being urged to improve their investment practices. They did. All that is now being deducted from the Federal dollars to be provided and any incentive to meaningful, sound management of those dollars is destroyed.

Similarly, I think if all rental income is immediately taken back in order to meet OMB requirements, there's little incentive, and I think it's important to build in what was built in in the utility area until these changes were proposed, which was some sharing in savings so that local authorities could better control some of their financial situation and have a incentive to improve their management.

Unfortunately, I think HUD right now at the moment is moving in the opposite direction and eliminating what incentives, both in the utilities and the interest income area, that previously existed—

it's now eliminating those. Therefore, I think, again, driving authorities back into poor management practices.

Senator LUGAR. Mr. Quinn, how would you respond to that question?

Mr. QUINN. Well, I think Harry did a more than adequate job of talking about some of the pitfalls of PFS. Obviously, one of the things written into it, is the more income that you generate, the less subsidy you receive; and so it could be contrived as saying that there are some negative rewards therefore for good management.

If I could, with your permission, Senator, I need to correct one thing for the record because I certainly wouldn't want anybody to leave here with a misunderstanding; and that is, to allude to the comments that Harry made at the beginning of his testimony in terms of our posture on the Brooke amendment, it's very interesting if you read this paper that we'll leave with you, it is not that the people in our part of the country are against helping the poor. On the contrary, the essence of the paper that I'll submit is that in order to give us the flexibility to go to something like a flat rent system those people then could be able to be housed by us and they could compete.

GEOGRAPHIC PROBLEMS

Right now, as I said, if a person is allowed $98 for their shelter and we can only charge them $20, and yet we're charged with fiscal responsibility, that person would gladly pay us the $98 because when she goes to the private sector she's going to pay $150. But for fiscal responsibility we've got to take in somebody that's going to pay us about $100 and so she is forced to go to the private sector. We are trying to create a system where once again we can be serving more of the ADC people because fiscally, in Colorado, in California, Utah, Montana, and I'm not sure about other States, we can't any more.

And I think to try—and, Harry, with all due respect, I think suffers from the same malaise as everybody else back here that you try to design a system on the east coast that's going to fit the West. And Harry has problems that are so different than mine. He needs every bit of operating subsidy that he's talking about. I fully support him in that argument. There's no question about it. We have a totally different situation out in the West.

Our demise has not been utilities. It has been a factor but not the factor. I think you need to understand that we are every bit as much committed to housing the poor as anybody on the east coast.

Mr. SPENCE. I apologize if I suggested otherwise. It's just as I look at those proposals and their impacts for us, certainly they would have a devastatingly different impact in Massachusetts. So, again, it may well be a regional difference.

It's why we, as an organization, do see a variety of views on this in different parts of the Nation and find the question of minimum rent a very difficult one because of some of its varying impacts around the Nation—the difficulty of structuring such a thing that would be fair and equitable.

Senator LUGAR. This colloquy does point out precisely what you're both saying, and that is the formulation at a national level of a policy in any area is likely to hit somewhere between the extremes, but clearly, in this particular case, because of the wide variety of utility costs, and the testimony you've given, Mr. Spence, is that this has become sort of a ticking timebomb of sorts. As capital became less of a factor, operating expense became more so. To the extent that that is not necessarily so in some parts of the country distorts the picture even more. And I suppose that if the subcommittee is relying upon experts such as yourselves to try to help us contrive, and maybe through our advice help HUD to contrive a system that better takes that into consideration.

I'm not sure we're making progress on that. I'm sure we need to and I think we're getting to the nitty-gritty of some dilemmas that will have to be faced by the large and the small, but also different sections geographically.

CONSTRUCTION COSTS

Let me just ask this question. Contrary to public opinion as the subcommittee has found in other testimony that construction of public housing appears to be even more expensive than section 8 new construction. We've already had testimony this morning about how expensive that is. Has that been your experience and, if so, why is that so?

Mr. QUINN. I don't think it's more expensive than the construction of section 8, but it probably is more expensive than the construction of a conventional unit of similar design right next door, and there are a variety of reasons for that, too. In fact, we were in the process of writing another position paper on that but we thought we'd hit the management issue first.

The inordinate delays—there's no reason, as our new regional administrator who's a former builder, Mr. Shepard, will tell you, why he can go and build a unit in 8 months that takes us 3 years. There's no excuse for it. We told Senator Armstrong the same thing when we met with him last January. HUD gets themselves involved in every possible way that you can imagine to the absolute extreme.

First of all, I think that in terms of site selection, they ought to have a set of standards to go by in terms of what to look for in a site, and they do have that, and they ought to go with that. I think that that's the job of myself, with my staff, with my board of commissioners, or if need be our regional planning commission. To have someone come from the regional office several hundred miles away to try to decide what's a good site in my town, and then they don't have a travel budget so they can't come down for a few months while you're sitting there trying to hold onto options; then when you finally get to the design stage and some neophyte architect up there thinks he's got to redesign your project for you, otherwise he's not doing his job, when you're paying your architect $80,000 to design it, as I said, this guy, fresh out of school, has got to try to redesign it. In most cases, they end up wasting 2 of the 3 years and you don't end up with a better product and it costs you a heck of a lot more.

Mr. SPENCE. I guess, Senator, I would be amazed if public housing were more expensive if you count the total cost of section 8.

Certainly, for example, I think that may be true if you look simply at construction costs because there are some areas, for example, in Massachusetts, where local and State law with respect to public construction, combined with HUD requirements, results in enormous delays; but I think if you look at the syndication, the total tax cost to the Government resulting from syndication of section 8, together with initial construction costs, it can't help but be more than public housing and I believe that GAO studies and the like have demonstrated that in the past.

I think much of it is a question of how you measure. If you look at tax costs, it's certainly there. I think that's much of the problem in this area generally, that our subsidy system for moderate and upper income people in the housing field is through the tax system, it's one that has an automatic escalator in it. People now paying 16- or 17-percent mortgages, get to deduct 16- or 17-percent mortgages from their Federal income tax. There's an automatic escalator in that Federal subsidy to the moderate and upper income homeowner.

When you look at the same increases on the public housing side, we're forced to face it every year as an appropriation, and it looks enormous. But I would hope we might take a look similarly at what we're paying to people—I mean, if you look at the new generation of homeowners who have come on-line in the last year or two, paying interest rates that you yourself have tried desperately to address because it's foreclosed so many people from getting into homeownership, I think you'd find, again, simply by interest rate, an enormous increase in subsidies to homeowners through the automatic escalator and the interest rate process.

We have to remember that, I think, when we look at the problems of escalating costs of public housing. The costs of housing everywhere in this Nation for all persons are increasing enormously.

Senator **Lugar**. Well, that point is certainly well taken and at the time you testified, Mr. Spence, I made notes of the fact that we have a sea change—I think you described it—in which capital costs used to be in decline, but now even if capital costs were in decline for older housing, utilities and other operating costs have taken up that gap.

If in fact the cost of capital generally in our society, maybe in our international economy, is expensive and becomes more so, how this all works out becomes more problematical in terms of any new supply, and if the old supply is very expensive there do not appear to be any easy ways of moving downhill.

3-YEAR CAP

On the other hand, when I met with the NAHRO group earlier this year, a number of officials came to Washington for an annual Washington meeting, they did have a great deal to say favorably about the idea of a 3-year cap, which you have addressed, and pointed out if the cap was at 1.4 it's one thing, if it's at 1.15 it's something else, and you suggested in fact that even a 1.4-plus cap would not take into consideration estimates that you felt would reach 1.5, 1.6, and other figures later on.

On the other hand, clearly the consensus of that group which was made of large and small—and we get back into the huge variety of cases again—tended to favor having a go at that kind of proposition and encouraged me to consider it. This is one reason we raise the question to expert witnesses now. We have taken it seriously.

Let me ask both of you, is the problem the thought that the budget proposal for a cap is too low or is it the concept of the cap at all that disturbs you; and if we don't get into the cap situation, are you willing to take your chances, I suppose, with the annual battle that goes on with OMB, HUD, and anybody else that may want to enter into this? I have no way of predicting if we're at one point 1.5 or something this year precisely where we would be next year, and it seems to me that one of the thoughts that many housing directors was even if it was grim news there was some virtue in certainty, if that is conceivable.

Will you wrestle with those ideas for just a minute because I'm certain that you have discussed them with many of your colleagues?

Mr. SPENCE. Both Mr. Quinn and I just came from meetings with our fellow members of NAHRO. I'm speaking today for the Council for Large Authorities, but I am a member of the housing committee of NAHRO and we spent Sunday afternoon some lengthy time discussing this proposal.

I can't speak for NAHRO in making these statements, but I can tell you something about the discussion. I think there was some real concern, even among those who within NAHRO who have most strongly supported that proposal in statements from some of them, that there were a couple of assumptions on which that proposal was made.

One was a belief that Reaganomics in this sense would work in a couple of ways. This proposal first was formulated about 1½ years ago by NAHRO—work in two ways. One, that the safety net would be in place, and those of us who deal with the poor see that that's disappearing so rapidly as to be terrifying for the poor; and two, that the rising tide lifts all boats and therefore I think this proposal—at least some would say individually from NAHRO today—that the conditions have changed fundamentally from the terms in which they first proposed it with the notion of local rent setting as being a possibility, looking to tenants to make up the difference.

Others comment similarly that it also depends upon reasonable and good faith commitment by HUD to adequately fund the operating needs of public housing, and that with take-back of interest income with arbitrary, imposed reductions that have doubled up in the utility area that reflect in no way the reality of what can really be accomplished in that area and the like, that that good faith in the administration of the program is very seriously in doubt now. Therefore, this kind of a proposal becomes a far more frightening one.

For myself, I believe the Congress can understand and does understand the terrible problems that all of us as a Nation are facing in rising costs—not just rising costs in utilities, but the increased proportion of our incomes individually that must go to utility costs and shelter costs, and therefore what naturally can only become some pressure to increase that in the national budget.

But I think if it is understood, while it faces us with hard choices, that nonetheless, those are choices in which this Congress for the last 2 years has shown itself prepared to make on both sides of the aisle, both parties, and both houses, because I think of the longstanding commitment to housing the most needy, to in fact making public housing that safety net, while otherwise this administration would further clip away.

So, yes, I would say we should commit ourselves to the trust that the Congress, if fully informed and fully understanding the nature of that problem, will support this program.

Senator LUGAR. Mr. Quinn, do you have a thought about this?

Mr. QUINN. Yes, Senator, I do. It's very interesting that you have people from both large and small and different parts of the country because, once again, it points out the tremendous difference in trying to set a formula that's going to cover the Bostons and the Kit Carson, Colorado.

I did not refer in my testimony to this study because I just picked it up yesterday. As Harry said, we were both down in Miami at the NAHRO Housing Conference. It's a study done in the Southeast by the regional vice president for housing for the Southeast. It shows that of the 18 housing authorities he surveyed in Alabama, Florida, Georgia, Kentucky, Mississippi, Virginia, and West Virginia, 18, 8 of the 18 received more in operating subsidy this past year than they lost because of the PFS.

Once again, when you get a formula and you plug things into it, some people get shafted and some people get more than they really need. And once again, that's why we have continued to harp on the local autonomy because personally all that we would need is operations plus ten percent for reserves, whereas other people are faced with going down the tubes because the formula can't react quick enough to make up their losses.

FLEXIBLE OPERATING SUBSIDIES

In terms of operating subsidies, are we willing to take our chances? Where we're coming from in our part of the country, if you were to give us the local flexibility, if you were to get rid of the ridiculous mandates of the Brooke as they affect us in Colorado, I guarantee you two things would happen. We would house the poor. We would house the ADC recipient. We would make it on operations and we would not have to be beholden or be coming back here begging every year such as some people are because of the unique situations they have to be in.

And I'm saying that we need to set up a system so that Harry can serve the thousands of people that he serves and be given a level of operating subsidy that they need in Boston and yet we ought to be able to operate in a feasible way without penalizing anybody. You can't do it under one system is our argument.

Senator LUGAR. Just out of curiosity, which eight states in this survey receive more money than they lost?

Mr. QUINN. It wasn't eight states. It was different authorities. One lost $21.30 per unit month and their subsidy was $37.10 per unit month, so they picked up $16 per unit per month more in subsidy than they lost.

Senator LUGAR. Where was that?

Mr. QUINN. That happened to be in Alabama. Two were in Alabama, one is in Florida, one is in West Virginia, one in Virginia, one in Mississippi, one in Georgia—they're all over.

Senator LUGAR. Can you explain, just for the benefit of the record, how this is possible? In other words, you're sophisticated people and know how it is possible, but to those of us who are not following these things day by day would be curious as to how you could lose $21 and get back $37 from the Federal Government.

Mr. QUINN. Senator, all I can say is that I didn't put this survey together and I would probably have to give it my best guess. Maybe you should have the preparer of the survey come before you sometime, but I would assume because it's based upon projections sometimes maybe people might load up at one end or underload at the other in order to guarantee that they're going to get enough to survive. Maybe with smaller agencies that would work. Maybe larger agencies can't do that. There are a variety of things. When you get into something as complicated as PFS, when you take all the square roots and everything else that's thrown into it—there's a variety of ways, as I said in our testimony, there's as many ways to beat the system as there are administrators to think of ways to do it.

Senator LUGAR. One of you said yesterday that you separate these small situations from the large ones—I'm trying to get a handle on where do you draw the line. Do you have one system for the largest 130 and another system for all the rest?

Mr. QUINN. In my estimation, the large housing authorities in this country need to be considered separate. They have unique problems and they need to be addressed. They cannot be defunded on their subsidy. They need to have that addressed.

I think we could be deregulated. I think of the 2,700 other housing authorities, the vast majority of us could be deregulated and do the job we were intended to do in the 1937 Housing Act.

Mr. SPENCE. I would just emphasize a couple of things, Senator. One, that I think HUD's own studies have recognized this failing in the PFS system of the misallocation between small and large. Apt Associates performed a study for HUD and OMB a couple of years ago, the result of which really emphasized this problem in what was the first really national effort in any area to produce a distribution formula at this time.

I think the system certainly can be improved in that way, and one of the ways would be to reflect difference in size. I would want to emphasize, if an authority receives more than its deficit, it can use those dollars under PFS in order to build up a reserve which any sound real estate man—I think the private people in the room would agree that any sound real estate operation desperately needs, but if their reserve goes over a certain level—which I don't remember off the top of my head what the minimum or the maximum reserve amounts are—it changes each year, but if it goes over a certain level, those dollars go back to HUD.

So it's important to put those numbers in perspective. They receive more, but if their reserves go over a certain point, the dollars go back to HUD. So it allows them dollars to provide for responsible management, but not—let me emphasize—that doesn't mean those dollars are lost for public use. If they are more than are needed, they go back to HUD.

Our concern right now are the dollars that are desperately needed are being taken away at the same time by HUD in large cities in a very peculiar misallocation of resources.

Senator **Lugar**. Let me ask this question. As was pointed out in the testimony today, the administration did not propose a minimum utility and rent as has been reported in some cases to public housing tenants. Can you give the subcommittee some guidance as to how to determine a fair amount which every tenant ought to pay? For example, just as a starter, for example, should every family be required to pay at least $50 a month?

Mr. **Spence**. My inclination certainly from our perspective would be no. I believe the result of that would be, in Boston at least, that you could have situations in which you'd have the irony of the program whose purpose is to house those who can't be served by the private market who would be priced out of public housing. Those people, it's true, would pay much more in theory in the private market. The problem is the reality when they go in the private market is not that they are given the choices between paying $50 a month to a housing authority and $300 to a private owner. It is $50 a month to a housing authority or tripling up, jammed in with other families and the like.

I think a $50 a month minimum in particular I'd be concerned about—I'd have to look at it—but I'd be concerned about its impact on the elderly. There are many elderly in Boston with very low incomes for whom $50 a month rent might put them in some serious situation with respect to other costs.

I don't want to reject any proposals out of hand because I think this is a difficult area, one we've been struggling with and trying to come up with some standards for. I think the issue is how to come up with a standard that both reflects a reasonable number or a reasonable approach and yet does not get us to the anomaly of saying some people are too poor to live in public housing and therefore lead a nomad existence or do what I think many poor in Boston do, which is they live for 9 months in a private apartment until they're caught up with because they simply can't pay the rent and then they move to the next place and try it again, in extraordinarily dangerous and terrifying conditions, in formerly paying rents that in fact are collected about 25 percent of the time because the people who live in those units simply can't afford to pay.

The choice is not really then between living in a private rent unit and paying $250 or paying $50; it's being a nomad or paying $50. At least I'd want to look very hard at whether it would price particularly elderly people out of the public housing market in some cases.

Senator **Lugar**. Mr. Quinn, do you have a comment?

Mr. **Quinn**. I guess my response would be that I would be, first of all, concerned about the elderly because they are the hardest hit. I think that as you would look through our studies here you'll find that, once again, one of the problems through Brooke—Harry alluded to the system of deductions the larger authorities happen to support. We in the small and medium happen not to support it. What happens in a case like that, if a family is working, the more dependents they have, the larger tax break they have, so the more take-home pay there is, if they happen to be on public assistance, the more people in the house, the larger the grant, and we go exactly backward. The more they get, the more we start deducting. And so with the real large families, when you take $300 off for every kid and you take 25 percent or 30 percent—30 percent of nothing is still nothing—the example I used in my testimony, that person pays us 2.2 percent, and that type of thing is wrong.

Whether you can set a flat fee at $50 or some other figure, I'm like Harry; I would have to look at that figure, but I think the whole system as it presently stands is backward and penalizes too many people.

Senator LUGAR. Well, now you have suggested, Mr. Quinn, a rather bold idea, that 2,700 authorities, more or less, might be deregulated altogether. HUD has initiated a number of deregulatory changes designed to lift regulatory burdens, to provide more management discretion, but obviously it's not enough.

Could you describe what deregulation would mean? In other words, what should the law contemplate if we were to write that in the appropriation situation this year?

Mr. QUINN. For example, if we were to return the power of the housing authorities back to the local boards of commissioners, as it was envisioned in the Housing Act of 1937 and get back to some more local control, I do think—in the past 10 or 11 years HUD has totally usurped virtually all the power of the board of commissioners to the point that right now their basic function is probably to hire the director. After that, the chairman signs standard forms that are mailed down and you get a letter and say sign this, if you don't you won't get your operating subsidy. Everything that's sent down to you is threatened with some clout, that if you don't do this—you don't have to, you're still autonomous, but if you don't, you don't get your operating subsidy. They force you to a posture that you can't survive without operating subsidies and then they say you don't have to sign it, but you're damned if you do and you're damned if you don't.

Our feeling in our part of the country is if the local control was returned back to the board of commissioners, for instance, if we set our own flat rents, it would be reasonable and would tie virtually dollar for dollar for the shelter on ADC, for example, and if HUD still had the right of review so that if I wanted to charge $120 for a two bedroom and the guy 40 miles away wanted to charge $200, HUD would come down and say, no, there's not that type of difference 40 miles away in market. They would have to be reasonable. They still would have the opportunity to do their equal opportunity housing reviews to make sure that we weren't discriminating. I think those things are essential to the proposals we're talking about. But we are so totally overregulated at this moment that we cannot move without them dictating virtually every step and therefore they have made it a complete morass. And I would suggest a total deregulation. We have talked about HUD has tried to deregulate. We haven't seen those regulations. They're talking about the lease and grievance procedure and a lot of things. If they're coming out they're on the pony express because we haven't seen them in our part of the country.

I understand they're going to go to 30 percent of income and have $400 for each dependent instead of $300. Well, that's twiddledee and twiddle-dum. If you're going to go to 30 percent at 1 percent a year—where are you? Thirty percent of nothing is still nothing. And I really think people are totally missing the boat.

DEREGULATION

Mr. SPENCE. Senator, I'd like to comment on the issue of deregulation in a couple areas. One, I guess, because I've been partial in my testimony, let me mention one area where we at least have experienced some valuable and useful deregulation which is in the construction area.

On an experimental basis the Boston Housing Authority through the work of Assistant Secretary Abrams has been relieved from prior approval requirements for all of its construction steps, and the result, we hope is we'll be able to put into construction roughly $600,000 more than the dollars accorded us would otherwise accord because the dollars would have been chewed up in inflation. This is one area where we have been supported and assisted by this administration and by Assistant Secretary Abrams in particular.

Similarly, in areas involving energy savings he's been supportive.

But let me emphasize that overall I think what we're seeing, unfortunately, is not a comprehensive deregulation but, rather, a change in regulatory priorities. The administration is interested—there's been a history of a number of years of HUD regulating with respect to social protections for low income persons, protections of those persons in the system. Those are being removed in the deregulatory process.

Now, however, instead, there is being proposed a very strict set and very extraordinarily tight set of regulatory procedures whose purposes are to protect the public purse and reduce the investment. So, for example, a statement that you shall have retrospectively reduced energy consumption (a) at least as much as the private sector in your area and (b) in addition, by an amount due to all of your capital investment, a double accounting which is brutal. That represents a high level of regulation, but it's regulation for a different purpose.

Similarly, I was alarmed to learn that there's a proposal that from now on HUD will require that housing authorities only use particle board cabinets, to get to a very practical and simple issue—particle board cabinets in construction. Particle board, as anybody knows, gets soaked with water and after 3 years it's ruined.

A tightly regulated system requiring us at the local level not to use good quality cabinets would save us dollars in the long term—absolutely save us dollars in the long term. But it's not that we're deregulated; we're regulated in a new direction away from protections for the poor and toward protection for the public dollars. There's no clear evidence of a deregulatory intent.

Senator **Lugar.** Well, the problem is that the budget problems which bring us together today dictate at least some degree of control. I think we're all talking about that and the question is, I suppose, how to do this in as reasonable and humane a way as possible.

Mr. **Spence.** I just think mandating the particle board is a level of control—I think here one can say the dollars available, now figure out how best to use them; but not to say you can only use them for particle board. It would be tragic.

Mr. **Quinn.** Especially if you're going to maintain it for 30 or 40 years. The same thing with cheap plumbing fixtures. It's better to spend a buck at the front end than 10 bucks 3 years later.

Senator **Lugar.** Let me just ask this. If we adopt the philosophy in the public housing area such as we've wrestled with in this subcommittee and the full committee last year on community development block grants, you recall one of the major points of departure in that debate was that local communities—mayors, councilmen, county commissioners, what have you—ought to have maximum discretion in spending those moneys provided that in a broad sense they would be spent for people with low income and that there was no discrimination of expenditure of the funds based on race, creed, color, sex, what have you. But with some broad provisos of general policy, the thought was that a good number of things might proceed, including some housing as a discretionary part of some of those moneys. We had testimony from councilmen in Dallas that indicated that HUD there was determining the specific mix between elderly and low income that were nonelderly and what have you, and that city council wanted to have that authority. It seemed to us to be a reasonable proposition.

Now it may be that in this particular year we take a look more specifically at the public housing thing. Now in doing this—this is the reason I'm so tedious on this point—Mr. Quinn has suggested that 2,700 housing units other than the 130 largest might very well exist better under a broad deregulation which still stated national goals of nondiscrimination and an emphasis upon service of the poor and allowed commissioners or whoever the governing body is to do the job at that point.

Now what would be the effect of that kind of operation on the larger 130? How much deregulation can you stand? In other words, what's going to happen over on that side?

IMPACT OF DEREGULATION

Mr. **Spence.** Well, I think a lot of things can happen with deregulation. In any industry, dollars are the lifeblood of an organization, and the thing I fear always is the process by which apparently local choices are made but, of course, dollars really force the conclusions of those choices. And I would point to, as an example of that, what seems to me the very—I would have to say—in a sense, disingenuous recommendations of the President's Commission on Housing with respect to public housing.

That Commission has recommended that with respect to public housing a system be put into place in which dollar limits on subsidies would be set for local housing authorities at the amount that a voucher for private markets would provide, and then it says local decisionmaking could apply. The housing authority could choose either to continue to house poor people or sell its properties or to house upper income people or do whatever it wishes.

Well, those aren't really choices. The economics of that situation force the conclusion. If the dollars are insufficient to house the poor, then either one will sell or house moderate- and upper-income people. I worry about so-called deregulation being a guise for in fact compelled choices that derive from the dollars.

And since so much of this administration's efforts with respect to housing are driven by OMB concerns about budget matters, I think it's a hard context in which to propose that deregulation is likely to produce anything other than that result, and I think in effect become a guide under which the commitment to housing the poor which is the safety net is withdrawn and the safety net disappears.

I think these are not good times for that kind of a proposal for certainly large authorities.

Mr. **Quinn**. It's interesting to note, though, Senator, that, you know, people say the proposal that we put forth is not perfect and it's interesting that our proposal has to be perfect and yet the one we've been operating under for 11 years is anything but perfect. In fact, in my testimony, I've pointed out far more examples of why it's terribly imperfect, why all these inequities are in it—it's just virtually discriminatory toward many classes of people.

The Brooke has had the effect in our part of the country of seeing to it that we are not housing ADC recipients. Eighty-five percent of the ADC recipients in towns where there are housing authorities in Colorado are living in the private sector, not under the housing authority. And so it's had the total reverse effect.

What we're saying is that it might have been designed for New York or Boston or Detroit, but what happened when it gets out to our States, it's been a total reverse. And what we're saying is that we think we can do it better with the deregulation.

Senator **Lugar**. Will your proposal work in the 2,700-plus housing authorities?

Mr. **Quinn**. I haven't talked with all 2,700, but I've talked with quite a few of them. In fact the small housing authorities met 2 days ago down in Miami and there were quite a few people there. I talked to the delegate from Colorado Springs and he told me that those folks are still committed to our basic posture, which is the local flexibility. That is where the bulk of us are coming from, and yet we really understand what the problems are that the larger housing authorities have. They are dealing with something that really is unbelievable and they need all the help they can get.

Mr. **Spence**. I would just emphasize, Massachusetts as a State, has the largest number of housing authorities of any State in the Nation because Massachusetts as a State has a State public housing program and is committed as a State to this program.

I think you would find that if we were sitting here today with small housing authorities from Massachusetts, with which I communicate a great deal, you would find the difference is more regional than size. For Massachusetts small housing authorities, they face on a small scale exactly the problems we face and the kinds of situations that Mr. Quinn describes is not applicable often to their circumstances. So I think it's as much a regional difference as a size difference.

Senator Lugar. Where does this region go? Do we draw sort of the class situation—New England and the upper Midwest? Is this the region that we're talking about because of utility costs or because of heavy industry and unemployment, or why would there be that kind of difference?

Mr. Spence. Primarily, I think the biggest factor and the factor that makes the subsidy most critical obviously is the weather, and we're talking about the Middle West and the Northeast, although there are certainly circumstances where utility costs are high in some of the very hot climates in Arizona and places like that where utility costs are similarly high.

My own inclination is to believe that this is not something where one can draw a line. I think that it's an area that far more work needs to be done in. HUD has just begun to look seriously at the PFS system in ways to change it and we ought to be following up on the work that they've been doing in this area and seeing what the results of that study and others have been and pursue that course.

Mr. Quinn. Harry is probably right with the cost of fuel in New England. I grew up in Connecticut and know the cost of fuel oil. My brother is still there. But there is a different situation. Certainly we have cold weather out where I live, but it's not as bad as New England and the costs aren't as bad. Plus he has a very old housing authority with a lot of high rise type apartments for families. The only high rises we have are elderly units, most of our units are single family houses, duplexes, insulated to R-30, with storm windows and storm doors, weather stripping, and caulking. You can't compare the type of housing authority these folks are talking about with what the bulk of us more western, newer, smaller housing authorities have; and that's why you can't set one set of rules to govern both of us.

Senator Lugar. Well, I agree with you and I suppose that in a fairly short period of time, at least for this particular cycle, we shall have to try to use the best ingenuity we can to make these demarcations where they are just and to attempt to bring the greatest flexibility of management to the systems you describe. This is why I appreciate your patience in eyeing the Chair to keep drawing lines back and forth either geographically or by degree days or however else we may want to see it, and I know staff, both majority and minority, has been listening carefully and will feast upon your testimony which has been most thoughtful.

At this point we will adjourn the hearing with thanks to our witnesses and to all the participants this morning.

[Whereupon, at 11:55 a.m., the hearing was recessed until April 14, 1982.]

FISCAL YEAR 1983 HUD AUTHORIZATIONS

WEDNESDAY, APRIL 14, 1982

U.S. Senate,
Subcommittee on Housing and Urban Affairs,
Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

The subcommittee met at 9:30 a.m., in room 5302, Dirksen Senate Office Building, Senator Richard Lugar (chairman of the subcommittee) presiding.

Present: Senators Lugar, Riegle, and Proxmire.

Senator Lugar. This hearing of the Senate Housing Subcommittee will come to order. We have 2 very active days of hearings as we discuss the HUD authorizations and the many facets of housing plans in this country. The Chair would ask each of the witnesses to do this—I know it's a very difficult thing to do, but if you could summarize your testimony and give the gist of it in 5 minutes of time, this would be very helpful. Otherwise we will have great difficulty simply getting through the witness list today with fairness to each of the witnesses who have come.

All of the prepared testimony or remarks that you would want to extend after this hearing will be made a part of the record for all other Senators. As we are joined by other Senators, they may wish to ask questions. But in any event, we will proceed in this order: Mr. Snyder, Mr. Gourley, Mr. Waldo, Mr. Pryde, and Mr. Smith. In that order, try to confine your initial remarks to 5 minutes of time.

It's great, as always, to have you, Harley, as an excellent leadoff witness today. Will you please proceed with your testimony.

STATEMENT OF HARLEY W. SNYDER, PRESIDENT-ELECT, NATIONAL ASSOCIATION OF REALTORS

Mr. Snyder. Thank you, Mr. Chairman. I'll have to reduce mine by about 30 minutes in order to get it down to 5, but I'll make every effort to do that.

It is a pleasure, Mr. Chairman, to testify before you today. My name is Harley W. Snyder. I'm a realtor from Valparaiso, Ind. I'm president-elect of the National Association of Realtors. We're here today on behalf fo the 700,000 members of the Association to present our views on the Housing and Community Development Act Amendments of 1982 and related legislative proposals.

Our fundamental concern with all Government housing programs, existing or proposed, is based on the long-standing National Association policy that the Federal deficit must be brought under control. Our views, critical or supportive, are neither personal nor partisan. The principal thrust of this Association's comments has for years been one of fiscal responsibility and balanced monetary policy.

As you're keenly aware, sir, the housing industry is in its worst depression since the 1930's. Existing single-family home sales have fallen to a seasonally adjusted annual rate of 1.8 million units—less than half of their previous peak level achieved in November 1978. I think the real problem with that is that so far 3.2 families have been deprived of the privilege of homeownership.

We think that there is a realistic solution and we think it's urgent that we get the existing housing market moving by the quickest means available and this, in turn, will stimulate the market for newly constructed homes. Our concern is housing. Housing of all types.

RECOMMENDATIONS

We've offered you, I think you are aware, two different alternatives, one of which is a mortgage revenue bond proposal, the other is a $5,400 credit to first-time homebuyers and a $5,400 credit to lending institutions making loans to first-time homebuyers. We think all of these recommendations are viable and could be of substantial use.

Turning to expanded roles for FHA, for some 40 years the basic FHA 203(b) mortgage insurance program has satisfied the needs of the borrowers and lenders that have used it and thus it did not need an alternative form of mortgage instrument. Many of the realities of the marketplace, however, that determined FHA's original parameters and procedures have drastically changed. For FHA to remain viable and useful, its basic programs must be adjusted to meet marketplace forces.

The same quality of attention that Congress and regulators have devoted to conventional mortgage forms should also be provided in FHA's basic 203(b) single-family program. I think FHA needs to look at developing alternative forms of mortgage instruments, however we would also urge that they must not get out of the 30-year fixed rate, long-term mortgage, and we support your past efforts in that area too, sir.

In regard to alternative mortgage instruments, we support the administration's proposal to insure adjustable rate mortgages. We have earlier testified elsewhere that we feel that the marketplace should be given a chance to determine the acceptable parameters.

If FHA is authorized to offer a limited ARM program at this time it may be able to help break the stalemate.

The administration's proposed ARM instruments with their consumer safeguards limiting interest rate increases, the number of annual adjustments, and especially disclosure requirements should help minimize consumer skepticism and encourage lender participation.

The National Association of Realtors supports the administration's elimination of regulated mortgage interest rates for FHA single-family insured programs. We feel, and we've testified many times in the past, that this change is long overdue. Historically, FHA borrowers have been prohibited from paying discount points.

A more realistic floating interest rate should, in most cases, eliminate the need for discount points.

In regard to the GNMA mortgage-backed securities, the National Association of Realtors opposes cuts proposed by the administration in the GNMA mortgage-backed securities program at this time. We support a commitment level of $68.25 billion for GNMA's mortgage-backed securities program.

It will take a long time to provide a guarantee, I think, that investors will accept as a transition from a Government commitment on a mortgage-backed security instrument to a private sector commitment on the same instrument.

The Federal Government can best contribute to this development process by maintaining its commitment to the GNMA mortgage-backed securities program during the transitional period.

We would also urge the subcommittee to direct GNMA to guarantee securities backed by 5-year rollovers as provided for in S. 1702.

Just one final thought, and that is, I think it's natural to address the nation's housing and unemployment crisis in tandem and attempt to improve both problem areas with a single response.

But as we've noted earlier in my comments here, there remains a fundamental obstacle to our endorsement of these and similar proposals: that being increased deficits.

We, the National Association of Realtors, remain steadfast in our view that immediate relief for housing and homebuyers can best be accomplished through speedy adoption of our recommended changes to the mortgage revenue bond program in the House and Senate Conference on H.R. 4717, the Miscellaneous Revenue Act of 1981.

Mr. Chairman and members of the committee, we thank you for the opportunity to appear before you today and we stand ready to answer questions at your leisure.

[The complete statement follows:]

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
regarding
1982 AUTHORIZATIONS LEGISLATION FOR THE DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
before the
SENATE SUBCOMMITTEE ON HOUSING AND
URBAN AFFAIRS
by
HARLEY W. SNYDER
April 14, 1982

I am Harley W. Snyder, a REALTOR® from Valparaiso, Indiana, and President-elect of the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the 700,000 members of the Association, I am pleased to present our views on the Housing and Community Development Act Amendments of 1982 and related legislative proposals that are presently before the Subcommittee.

The prospect of an unprecedented federal budget deficit, the economic and social implications of the current recession, and election year politics have all contributed to significantly divergent proposals regarding the federal role in housing. The NATIONAL ASSOCIATION OF REALTORS® hopes that the debate generated by these alternatives will eventually result in a federal housing policy that is cost-effective, provides assistance where needed, and permits the marketplace flexibility in meeting the nation's housing needs.

Simply stated, our fundamental concern with all government housing programs, existing or proposed, is based on our long-standing National Association policy that the federal deficit must be brought under control. Thus, our views, critical or supportive, are neither personal nor partisan. The principal thrust of this Association's comments has for years been one of fiscal responsibility and balanced monetary policy.

Indeed, our perspective on the proposals currently before this Subcommittee, whether their purpose is to stimulate housing production and employment, establish foreclosure relief or provide low-income shelter assistance, is based on the principle of fiscal responsibility, regardless of the sacrifice that our business or any other sector of the economy must make. We continue to believe that quick-fix attempts to assist a select group or business is not an acceptable solution, whether the rationale be political, partisan or whatever because all must bear the cost of the program, including those not fortunate enough to receive the assistance.

Clearly, the complex problems now confronting housing do not lend themselves to simple solutions. A limited federal effort that essentially ignores this complexity could serve to exacerbate our already desperate situation.

STATE OF THE HOUSING INDUSTRY

We believe that the housing industry is in its worst depression since the 1930's. Existing single-family home sales have fallen to a seasonally adjusted annual rate of 1.8 million units — less than half of their previous peak level achieved in November, 1978. So far, 3.2 million resales with a market value of $229 billion have been lost. Please note, Mr. Chairman, that existing home sales traditionally comprise two-thirds of this nation's housing market.

Our interest-sensitive industry is crippled by record federal deficits measured in current dollars, percent of Gross National Product, or percent of personal savings and by their side effects — unprecedented federal borrowing and a severe shortage of funds for housing investment and ownership.

The ripple effect of record federal deficits:

- Has resulted in record real estate interest rates, double and triple normal levels and much higher during this Congress and Administration than any other.
- Has caused the loss in the value of every American's home up to 25 percent and caused the loss in the value of the average American's savings and investment in housing by 50 percent.
- Will completely offset the stimulating effects of last year's tax incentives to invest.

- Will limit recovery to about one-half the normal rate.

- Will provide only modest improvement in our nation's standard of living and a limited increase in jobs during the next three years.

- Will continue to cripple the interest-sensitive sectors of the United States economy, such as small business generally, automobiles, farming, exports and housing and the mature regions of the country, such as the Northeastern and North Central States.

- Will lead to greater economic concentration and conglomerate tying arrangements which will likely cause higher housing costs and less homeowner choices in financing and products and other services in the future.

IMPORTANCE OF THE EXISTING HOMESALES MARKET

A number of proposals recently presented to the Congress would authorize federal subsidies to help sales of new homes. At the same time a considerable number of bills have avoided this discrimination and have emphasized the economic benefits of an expanding home sales market as well as new homes.

- Each sale of an existing home generates $16,100 in Gross National Product, including the products and services used to prepare a house for resale, remodeling, the utilization of real estate specialty services (real estate brokers, attorneys, lenders, etc.) and after-sale expenditures for capital improvements in newly acquired homes.

- The ratio of existing to new homesales shows that, generally, three existing homesales occur for one new sale. While the impact in the economy per existing homesale may not seem as dramatic as that of new construction, in the aggregate, existing sales have significant overall effects on the economy.

- Due to the 40 month decline in housing activity, the NATIONAL ASSOCIATION OF REALTORS® estimates the loss to the Gross National Product (GNP) due to low resales to be $40 billion.

A REALISTIC SOLUTION

What is needed is immediate, short-term aid that avoids the federal budget consequences that accompany spending side solutions. It is urgent that we get the existing housing market moving by the quickest means available and this in turn, will stimulate the market for newly constructed homes. Our concern is housing. Housing of all types.

Not long ago our Association presented testimony on S.2226 "The Emergency Mortgage Interest Reduction Payment Act." At that time we recommended that:

- Administrative and legislative changes to the mortgage revenue bond program proposed in H.R. 4717, currently in conference, be expedited. These changes will increase the number of bonds that can be issued and make mortgages provided by the bonds more readily available.
- First-time homebuyers be allowed a credit against Federal income taxes of up to $5,400 on the purchase of a home between now and December 31, 1982. Or,
- Mortgage lenders would be able to take a credit against Federal income taxes of up to $5,400 if they make home mortgages loans between now and December 31, 1982. In order to qualify for the credit, lenders would be required to use the amount of the credit to decrease the effective rate of interest on the mortgage by three percentage points for a three-year period. The result would be that more than 250,000 first-time homebuyers, who would not otherwise have been able to afford a home, could purchase a home in 1982.

Much, if not all, of the cost of such a tax credit program could be recouped through the immediate termination of the existing All Savers program, instead of its current ending date of December 31, 1982.

Revenue loss estimates for the All Savers program at the time of enactment, were $3.3 billion. As of this date, some $700 million of that amount has been "consumed" by the issuance of All Savers Certificates, leaving $2.6 billion unused by the program and available to our tax credit proposal.

We acknowledge that these recommendations are not within the purview of this Subcommittee, but we believe it is important to note them here and urge your support of non-deficit producing proposals such as the Emergency Home Purchase Act (S.2277) sponsored by Senators George Mitchell and James Sasser. This and other proposals from a diverse and bipartisan group of Senators and Representatives offer deficit-conscious tax expenditure bills which deal with the housing crises now, not so far down the road as to be ineffective.

It is natural to address the nation's housing and unemployment crises in tandem and attempt to improve both problem areas with a single response. Thus, Chairman Lugar and the Senate Democratic Emergency Housing Task Force have developed similar strategies that would simultaneously address both housing and unemployment. The NATIONAL ASSOCIATION OF REALTORS® appreciates the fact that these proposals acknowledge the budget strictures under which we must operate.

Each of these emergency programs has some merit. Nevertheless, we remain steadfast in our view that immediate relief for housing and homebuyers can best be accomplished through speedy adoption of the recommended changes to the mortgage revenue bond program in the House-Senate Conference on H.R.4717, the Miscellaneous Revenue Act of 1981. After action to make the mortgage revenue bond program effective, other proposals, preferably on the tax side, could be developed consistent with budget realities. There would be both legislative vehicles and time for another emergency step to be taken for housing.

EXPANDED ROLES FOR FHA

For some forty years, the basic FHA 203(b) mortgage insurance program has satisfied the needs of borrowers and lenders with its standard fixed payment mortgage instrument. However, many of the realities of the marketplace that determined FHA's original parameters and procedures have drastically changed, principally due to monetary policy decisions of the Federal Reserve Board since October of 1979 and the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 which began phasing out Regulation Q and deregulating depository institutions. Long- and short-term money rates have inverted making lending long and borrowing short a money-losing proposition. The relationship between mortgage rates and inflation has changed as well, with the traditional "spread" for a real (after inflation) rate of return increasing beyond traditional levels. The last few years have also seen the extremely volatile and expensive costs of capital further damage the flow of adequate money into mortgage financing. For FHA to remain viable and useful, it must offer some new mortgage instruments to properly serve the marketplace.

Last year, the Federal Home Loan Bank Board addressed this dilemma for conventional mortgages by issuing sweeping regulations authorizing its federally chartered institutions to develop adjustable rate mortgage (ARM) loan instruments designed to assume whatever characteristics deemed necessary. The Comptroller of the Currency also authorized ARMs for national banks. However, skepticism, the lack of uniform mortgage instruments, and most importantly, the present high interest rates have combined to thwart the development of ARMs.

Congress and HUD should work to ensure that FHA mortgages offer consumers new choices similar to those authorized for conventional instruments. FHA, which established the viability and utility of the long-term, fixed rate mortgage instrument, should now be provided the opportunity to assume the leadership for developing selected new mortgage instruments, such as ARMs, consistent with that agency's historic role of consumer protection.

It is for this reason that we applauded your initiative, Chairman Lugar, when you introduced the "FHA Revitalization Act of 1981" (S. 1702), which would help to make FHA more responsive to the needs of the housing marketplace of the 1980's. Whatever FHA can do to develop new mortgage instruments that can satisfy the needs of lenders, yet fit within the budget of homebuyers, should be encouraged by the Congress.

ALTERNATIVE MORTGAGE INSTRUMENTS

While the NATIONAL ASSOCIATION OF REALTORS® believes the fixed payment mortgage should remain the mainstay of the FHA single family mortgage insurance program, we do support the Administration's proposal to have FHA insure adjustable rate mortgages. FHA ARM programs will increase the acceptance of the concept of the adjustable rate instruments, thereby rendering these mortgages more attractive to consumers. Lenders hesitate to issue a long-term, fixed rate mortgage and the public is reluctant to accept anything else. If FHA is authorized to offer a limited ARM program at this time it may be able to help break the stalemate in the marketplace presently thwarting development of ARMs that are nationally accepted by lenders and consumers.

The Administration's proposed ARM instrument with consumer safeguards limiting interest rate increases, establishing the number of annual adjustments, and requiring disclosure information should help minimize consumer skepticism and encourage lender participation. Broader secondary market acceptance of these new instruments would result with the involvement of FHA.

NEGOTIATED INTEREST RATES

The NATIONAL ASSOCIATION OF REALTORS® fully supports the Administration's elimination of regulated mortgage interest rates for FHA single-family insured programs. We feel that this change is long overdue. A negotiated rate is clearly more reflective of the marketplace and will eliminate a problem that has plagued Realtors®, sellers and homebuyers for years -- discount points and who pays them. Historically, FHA borrowers have been prohibited from paying discount points. These points are typically built into the price of the house by the seller. This has resulted in inflationary high sales prices for properties to offset the seller having to pay the lender points. A more realistic "floating" interest rate should, in most cases, eliminate the need for discount points.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA)

GNMA MORTGAGE-BACKED SECURITIES

An adequate supply of affordable mortgage credit in the future is dependent on an effective secondary market that facilitates investment from both traditional sources of mortgage finance such as thrift institutions, banks, and life insurance companies and non-traditional trusts and credit unions. The federal government can best contribute to this development process by maintaining its commitment to the GNMA mortgage-backed securities program during this traditional period.

When the Reagan Administration resolved to cut government spending, our Association applauded the initiative, believing the large federal deficit contributes significantly to high and volatile interest rates and economic instability.

Nonetheless, the NATIONAL ASSOCIATION OF REALTORS® opposes cuts by the Administration in the GNMA mortgage-backed securities program at this time. We believe that such action would seriously jeopardize the future acceptance of conventional pass-through security instruments. We support a commitment level of $68.25 billion for GNMA's mortgage-backed securities program. Continued federal support will provide needed time for the private sector to produce an instrument that will have the same public acceptability in the capital markets as the GNMA security instrument does now.

According to HUD's own figures, at the end of 1981, the outstanding balance of privately insured conventional loan pass-through securities was only $14.9 billion, up more than $6 billion from the end of 1980. These statistics are a positive indication of the capacity of the private sector to accept conventional mortgage-backed securities, thereby assuming some of GNMA's function. But it will take more time to guarantee that investors will accept a transition from a government commitment on a mortgage-backed security instrument to a private sector commitment on the same instrument. The future of mortgage credit availability will depend on how we handle this transition.

MULTIFAMILY HOUSING

One harsh reality that has always been with us is that low-income families need low-cost housing. Even in this country, still the best housed in the world, there are some who always need assistance in meeting their shelter needs.

At this point two proposals, divergent in their approaches, are under consideration. The Administration wants to shift the emphasis in multifamily housing to existing units. Others endorse a production program -- albeit with substantial programatic changes predicated on the assumption that federal costs can and should be contained.

The Administration proposes terminating the Section 8 construction program and purging the pre-construction pipeline of unfulfilled commitments. In relying completely on the use of existing rental housing stock, the Administration would essentially ignore current or future shortages in the low-income rental housing supply.

Senator Dodd's "Rental Housing Production and Rehabilitation Act (S.2171)," described as an Urban Development Action Grant approach to multifamily housing production, would use federal assistance to leverage financing for rental projects construction. State and local governments would play a prominent role in determining rental housing needs, design and location.

One attraction of the Dodd proposal is that it seems to offer greater flexibility in using federal assistance. Another is the potential for developing a closer partnership between state and local housing agencies, builders, private investors and the federal government. Cost-saving innovations in the design and the financing of low-income multifamily housing should be encouraged by this proposal. In a less difficult economy, in which federal deficits can be controlled, Senator Dodd's proposal would provide an excellent starting point for considering an overhaul of federal low-income housing construction programs.

The low-income housing construction and rehabilitation provisions enacted last year in the Economic Recovery Tax Act, significantly enhance the attractiveness of multifamily rental housing as an investment. The Accelerated Cost Recovery System (ACRS) accorded to low-income housing and other real estate and the 60-month amortization of expenditures to rehabilitate low-income housing are substantial incentives to unsubsidized multifamily investment. At this time, we would, therefore, suggest using what is already available to stimulate rental housing construction rather than the low-income housing program proposed in Senator Dodd's bill.

We make this recommendation based on our long-standing concern that federal expenditures in all areas must be contained. The projected federal deficit demands that the most cost-effective measures be employed to provide low-income housing construction and assistance.

LOW-INCOME HOUSING ASSISTANCE

The Administration proposes modifying the Section 8 Existing Housing program to establish a low-income housing certificate, or voucher plan. The modified certificate appears to be more of an income assistance plan than a new housing policy. If this is the intent, significant policy implications are still to be addressed by our membership and the National Association's Multifamily Housing Task Force.

A Rental Rehabilitation program will be linked to the Administration's Modified Section 8 Certificate program. This proposal logically follows the Administration's shift in emphasis to existing housing. Indeed, given the Administration's 1983 HUD budget proposal, such a program is necessary if housing vouchers become the primary vehicle for federal housing assistance.

Existing rental structures -- many of which are admittedly substandard -- can and should be reclaimed for use. Rehabilitation of useable structures can provide employment while serving the long-term purpose of sheltering the poor. If this is true, and we believe it is, subsidies for multifamily housing production are questionable until the existing stock is fully recycled and occupied. When these substandard units are thus reclaimed, market demand should be more precise and thus new construction subsidy dollars could be more effectively utilized. The staggering long-term costs associated with the current federal multifamily construction program, particularly the Section 8 program, should not be perpetuated.

TENANT ELIGIBILITY

Last year House and Senate Conferees on the Housing and Community Development Act Amendments accepted a significant revision in the income eligibility requirements for federal housing assistance, targeting housing assistance to families with incomes below 50 percent of area median income. Section 323 of the 1981 Amendments phases in the change in eligibility by limiting occupancy in Section 8 and public housing to families that earn below 50 percent of an area's median income as contracts come up from renewal.

In limiting assistance to the very poor, professional property managers (who comprise the membership of our Association's Institute of Real Estate Management (IREM)) believe that while well-intentioned, this revision is perhaps too simplistic and ignores their practical experience which reveals that concentration of families in the 50 percent median income and below results in social and economic problems which increase management and operating costs and shorten the life of the project.

Congress should understand the impact that the 1981 Housing and Community Development Amendments may have on future HUD multifamily program costs. The lower number of families that will occupy Section 8 units in the 50 to 80 percent bracket of area median income range may well cost the federal government significantly more per family than the cost experienced prior to the 1981 Amendments. Indeed, management and operating costs are expected to escalate.

The Institute of Real Estate Management, anticipating these problems, is now surveying its membership for these cost estimates. When that study is completed the findings will be provided to the Subcommittee.

Thank you for providing me this opportunity to present the views of the NATIONAL ASSOCIATION OF REALTORS®.

Senator LUGAR. Thank you very much, Mr. Snyder. The Chair would note that the hearing has been joined by the distinguished ranking minority member of this subcommittee, Senator Riegle of Michigan, and Senator Proxmire of Wisconsin.

Mr. Gourley, would you please proceed with your testimony?

Senator RIEGLE. Mr. Chairman, since you've interrupted at that point, I have a brief statement I'd like to make. This might be an appropriate time to do that. I don't know whether Senator Proxmire has any comments to make, but Senator Dodd has a statement that he would like submitted for the record and I'd ask that that be included.

Senator LUGAR. Without objection, it will be included as though read.

[Statement follows:]

OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Mr. Chairman, the Federal Emergency Management Agency is proposing the elimination of two of its programs, the riot reinsurance and crime insurance programs. Both of them were enacted to deal with serious social problems in our major urban areas—the unavailability and unaffordability of riot reinsurance and crime insurance.

Unless these forms of insurance are both available and affordable, it will be impossible for our cities to flower. While I understand private riot reinsurance is presently available and affordable, I wonder whether we will be able to say the same thing after the first riot of the 1980's.

Moreover, two studies during the 1970's documented major problems of availability and affordability for crime insurance. Absent documentation of a dramatic turnaround in our battle against crime, I find it hard to accept the notion that we should jettison this program. It is particularly hard for me to conceive of doing such a thing at the same time that the President is proposing the creation of urban enterprise zones. I wonder how many businesses are going to set up shop in these zones without crime insurance.

Mr. Chairman, while I will be unable to attend the hearings this morning, I hope that these important issues will be explored thoroughly.

OPENING STATEMENT OF SENATOR RIEGLE

Senator RIEGLE. Mr. Chairman, first, I want to say I join you in welcoming our witnesses and I want to commend you for holding this hearing.

Today's hearing marks the second time in 3 weeks that representatives of the homebuilding and home finance industries have appeared before this committee to offer their views on housing legislation. During this time business failures in the housing industry, construction worker unemployment, depressed housing production, and restricted homeownership opportunities have continued to take their toll on the Nation's economy and on our people.

Nationwide, more than 10 million people are out of work. One in five construction workers is unemployed. Housing starts have dropped 46 percent over the last 3 years to the lowest point since

1946, and business failures for the first 2 months of this year are up 55 percent over the same period in 1981. In my own State of Michigan, unemployment has now reached 17 percent, which means that we have 725,000 people in our State who are jobless. Michigan housing starts have dropped by almost two-thirds between 1978 and 1981.

This is a crisis of enormous proportions that I feel demands immediate, urgent attention by the Federal Government. Regrettably, the Reagan administration refuses to respond in any meaningful way, urging us to wait for its economic policies to produce some major turnaround. That has not taken place and in the meantime the situation has grown increasingly desperate.

Mr. Chairman, I feel strongly that this committee should move immediately to mark up housing stimulus legislation. The building season has already arrived, and unless an assistance program is in place and working soon there's great risk that the industry will face another year in depression-like circumstances.

The committee has before it several proposals to boost the housing industry and while these measures differ in some details their basic purpose and general thrust is the same, and that is to get the housing industry back on its feet.

I really see no good reason not to proceed with the markup of this legislation where we can discuss the issues, resolve any differences that exist, allow the committee to vote, and send the matter to the Senate floor so that the Congress can respond to this problem before any more time is lost.

I thank the chairman.

Senator LUGAR. Senator Proxmire, do you have an opening comment?

Senator PROXMIRE. I have no opening statement, but I would like to say how much I appreciate the appearance of Mr. Waldo here. Mr. Waldo is a constituent of mine. He has a very distinguished and highly respected business record in Madison, Wis. and he represents an association which is national, and we are delighted to have you here this morning, Mr. Waldo.

Mr. WALDO. Thank you, sir.

Senator LUGAR. The Chair likewise welcomes Mr. Waldo, who is indefatigable in coming back and forth for these hearings, in fact all the witnesses here this morning are veterans of the trail. I would also like to comment that I appreciate Senator Riegle's statment about the need for stimulus legislation. As he knows, I share that.

Senator RIEGLE. That's encouraging news. I hope that we would do that, and I am available to work with you on that matter.

Senator LUGAR. Good. Mr. Gourley.

STATEMENT OF WILLARD GOURLEY, CHAIRMAN, LEGISLATIVE COMMITTEE, MORTGAGE BANKERS ASSOCIATION

Mr. GOURLEY. Thank you.

Mr. Chairman and members of the subcommittee, my name is Willard Gourley, and I have a case of sort of laryngitis and will you please excuse that. I am president of First Atlantic Corp., a Charlotte, N.C., mortgage banking company, and chairman of the

Legislative Committee of the Mortgage Bankers Association of America. I will summarize our very lengthy statement and ask that this statement be included in the hearing record.

[The complete statement follows:]

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Washington, D.C. 20005

202-861-6500

Mortgage Bankers Association of America

STATEMENT OF

WILLARD GOURLEY

PRESIDENT
FIRST ATLANTIC CORPORATION
CHARLOTTE, NORTH CAROLINA

on behalf
of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

of the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

Hearings on

1982 Authorization Legislation for the Department of Housing and Urban
Development programs and related legislative proposals

April 14, 1982

Mr. Chairman and Members of the Subcommittee, my name is Willard Gourley. I am President of First Atlantic Corporation, Charlotte, North Carolina, a mortgage banking company, and Chairman of the Legislative Committee of the Mortgage Bankers Association.* Accompanying me are Burton C. Wood, MBA's Legislative Counsel, and Glen Corso, MBA's Deputy Legislative Counsel.

We appreciate the opportunity to appear before you today to testify on the 1982 authorization legislation for the Department of Housing and Urban Development (HUD) programs and related legislative proposals. We should also like to share with the Subcommittee our views and concerns about several other important housing issues. These include the commitment ceilings on the non-subsidized, user-fee supported Federal Housing

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance Companies
- Life Insurance Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Pension Funds
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; Telephone: (202) 861-6500.

Administration (FHA) insurance and Government National Mortgage Association (GNMA) guaranty programs; the need for a preemption of state laws that restrict the origination of adjustable rate mortgages (ARMs); S 1805, a bill that would establish a new Federal Home Loan Mortgage Corporation (FHLMC) charter; an amendment to the current FHLMC act that would prohibit fee differentials being charged on any program; and two Administration proposed actions that will drastically reduce the production of assisted multifamily rental housing.

ECONOMIC OUTLOOK

This Nation is facing an economic crisis today. The crisis is one of conflict between fiscal and monetary policies. The result is exploding government deficits crowding out private spending and causing record high interest rates. High interest rates have been slowly destroying our interest-rate sensitive industries, especially in the housing field. Recognizing the need for action, MBA and five other major trade associations recently issued the following joint letter to the President and the Congress, urging that swift, bipartisan action be taken to reduce projected Federal government deficits:

An Open Letter to President Reagan and Members of Congress

March 3, 1982

Prolonged high interest rates are creating an economic and financial crisis in this country. In order to bring interest rates down, immediate action must be taken to reduce massive federal budget deficits. More than anything else, it is the spectre of an overwhelming volume of deficit financing which haunts housing and financial markets and poses the threat of economic and financial conditions not seen since the 1930s.

Given these circumstances, there is no alternative to: (1) slowing down all spending, not excluding defense and entitlement programs; and, if necessary, (2) deferring previously enacted tax reductions or increasing taxes. In order to have the necessary impact on financial markets, these actions should be taken prior to any increase in the ceiling on the federal debt.

Even with these actions, the restoration of financial stability and safety will be a prolonged process. It is necessary, therefore, to adopt immediate but temporary measures to address the critical problems of the industries which finance, market and produce housing for American families. These industries have unfairly borne the brunt of destructively high interest rates. Unless immediate and effective short-run measures are adopted, the continued devastation of these industries will, directly and indirectly, aggravate the federal budget deficit and greatly increase the prospect of a general economic and financial crisis.

In times of past crises in this nation, our political leaders have come together in a bipartisan manner to develop effective solutions in the common interest. Our nation is at such a time now. There will be no political winners if the Administration and the Congress fail to accommodate differences and cooperate in dealing with current serious economic problems. The threat to our nation demands prompt, effective and bipartisan action.

Llewellyn Jenkins, President
American Bankers Association

James F. Aylward, President
Mortgage Bankers Association

Fred Napolitano, President
National Association of Home Builders

Robert R. Masterton

Robert R. Masterton, Chairman
National Association of Mutual Savings Banks

Julio S. Laguarta, President
National Association of Realtors

Roy G. Green, Chairman
U.S. League of Savings Associations

Joint Statement of: American Bankers Association, Mortgage Bankers Association of America, National Association of Home Builders, National Association of Mutual Savings Banks, National Association of Realtors, U.S. League of Savings Associations

The inflation problem of the 1970s required restrictive monetary policy. This policy, followed since October 1979, has been costly, but is producing positive results. Now that inflation is coming under control, the Federal Reserve could consider easing its policy. However, excessively expansionary fiscal policy is forcing the Federal Reserve to keep monetary policy tight to avoid a resurgence of inflation.

The current conflict between a tight monetary policy and an expansionary fiscal policy has resulted in: 1) historically high rates of interest; 2) continued recession and risk of stalled recovery; 3) high unemployment; and 4) devastation of key industries heavily dependent on credit—especially housing, automobiles, and agriculture.

The current recession is, in part, responsible for this year's Federal government budget deficit. In normal times, the end of a recession would reduce the deficit as tax revenues increase with rising profits and incomes, and as government transfer payments for unemployment and other assistance fall. The primary problem of the current deficit, though, is that it will grow and not shrink as the economy begins to recover. That is, the scheduled tax cuts and defense and entitlement spending increases will more than offset any increased tax revenues from increased profits and incomes and other spending reductions. This expansionary fiscal policy would generate new inflationary pressures, if it were not for the restrictive monetary policy adopted by the Federal Reserve. While the restrictive monetary policy is successfully bringing inflation under control, it also causes record high interest rates. It is these high interest rates that have caused the current recession, imposing high costs on the economy in terms of slow or no growth, high unemployment, and low utilization of our productive capacity.

So long as tight monetary policy keeps interest rates at or near record high levels, it will continue the gradual destruction of interest-rate sensitive industries, such as housing, agriculture, automobiles, and other consumer durables. Soon the effects will hit public utilities, manufacturing, and other sectors heavily dependent on borrowed capital.

Federal Reserve Board Chairman Paul Volcker has testified that only a more restrictive fiscal policy can permit a relaxation of monetary policy and lower interest rates. In order to achieve a sustainable economic recovery this year, Congress and the Administration must reduce fiscal pressures by reducing the deficit, beginning in FY 1983. This reconciliation of fiscal and monetary policy is the only responsible way to bring about a relaxed monetary policy, which is the only way to reduce interest rates.

There are, of course, two ways to reduce deficits—reduced spending and increased tax revenue.

We believe it is imperative that the Congress carefully evaluate all government spending plans for FY 1983 through 1985, including both defense spending and in entitlement programs, including social security. Although the international situation calls for a strong defense posture, it is questionable whether our industrial base and our defense bureaucracy can efficiently spend an additional $33 billion in FY 1983. If such an increase in a short period of time exceeds our physical and managerial capacity to augment defense, then the excess dollars will be wasted or will push up prices.

An excessive increase in defense spending, in the absence of an extended recession or a national emergency, would have additional damaging effects on the economy. It would compete with the private sector for machine tools, materials, and industrial capacity at just the time when the private sector heavy goods industries will be recovering, putting upward pressure on prices in those sectors that will be passed along to consumers later on. In addition, the massive financing requirements for both defense and civilian production will put upward pressure on interest rates, at a time when government credit demands still will be high.

Defense spending also tends to be inflationary. The production of defense goods and services increases national income without increasing the stock of goods and services available for consumers to buy. The result is that consumer prices tend to be bid upward, inflating the economy. Since investors require a premium for inflation, interest rates are pushed upward as well. Unfortunately, the President's defense program, because of its massive size, will conflict with the recovery. The Congress should carefully review defense spending plans, to provide the long-term defense capabilities we need considering the limits of our productive capacity in the short term.

Deferral of a portion of the planned defense buildup offers two benefits. First, any spending deferrals for the FY 1983 budget will reduce the deficit by a like amount, reducing pressure on Federal financing. Second, deferrals will allow the needed defense projects to be more carefully planned and reviewed. As a result, less useful projects may be identified and delayed or cancelled while more promising projects that are delayed may be better administered and benefit from emerging technology.

On the entitlement side, Social Security spending is projected to grow by about $15 to $20 billion in each of the next few years. The Congress should carefully review the Social Security budget, to consider not only the financial soundness of the program, but also the level of benefits and the automatic indexing of benefits.

If spending cuts sufficient to control the deficit cannot be achieved, then tax revenue increases should be considered. However, Congress should take note of the importance of our reduced marginal income tax rates in encouraging saving and investment in the domestic economy. Any tax increases should be temporary and should be designed to minimize their potential negative impact on savings and investment.

HOUSING STIMULUS PROPOSALS

In testimony before this Subcommittee last month, MBA endorsed the concept of a housing stimulus program as contained in S 2226, "The Emergency Interest Reduction Payments Act of 1982." After MBA's testimony last month, the Senate Democratic Caucus announced a stimulus proposal that contains some elements similar to the program in S 2226, as well as a mortgage payment assistance program for existing homeowners and proposals for funding multifamily rental projects that are in the production pipeline. MBA believes there is a great deal of merit to the Caucus proposal, as announced, and we urge the Congress to enact speedily legislation that combines the best features of both proposals in order to revive the housing industry and propel the economy out of the current recession.

FHA AND GNMA-MBS COMMITMENT LIMITATIONS

The Administration's FY 1983 budget would set commitment ceilings for the FHA mortgage insurance and GNMA mortgage-backed securities (MBS) program at $35 billion and $38.4 billion, respectively.

MBA is opposed to any ceilings being imposed on the non-subsidized, user-fee supported FHA insurance and GNMA-MBS guaranty programs. Rather than inflexible ceilings, the demand nature of these successful programs argues for the setting of targets only. If

Congress does, nonetheless, impose ceilings on these programs, they should be high enough to permit these programs to operate responsively to consumer demand and without disruption. The Administration's proposed ceilings could well prove to be inadequate to meet the demands for FHA-insured loans, particularly if interest rates abate or a housing stimulus program is enacted in FY 1983. The Administration figure for the GNMA-MBS program is particularly troublesome and could be totally inadequate in light of past experience with the program. The Administration has also proposed a "supplemental reduction" in the FY 1982 GNMA-MBS level of $20.25 billion to bring it down to a ceiling of $48 billion.

Prior to the recent introduction of various housing stimulus bills, such as S 2226, MBA had serious concerns that the Administration's proposed FHA and GNMA-MBS commitment ceilings for FY 1983 were clearly inadequate, particularly if the housing industry enjoys even a modest recovery in 1983. Possible enactment of these housing stimulus measures promises an even more vigorous housing recovery and even greater activity in the FHA and GNMA programs, thus necessitating that FY 1983 commitment ceilings be higher than those for FY 1982. MBA urges that in order to accommodate this potential demand, the commitment ceilings for the FHA and the GNMA-MBS programs be set above the levels of $40 billion and $68.25 billion, respectively, agreed upon for FY 1982. The higher ceilings should be based on objective estimates of potential demand for FHA mortgage insurance and GNMA-MBS guaranties from whatever housing stimulus program is enacted. MBA also opposes any reduction in the FY 1982 GNMA-MBS levels of $68.25 billion, in order to insure sufficient commitment capacity for a housing stimulus program that might be enacted before the end of FY 1982.

MBA believes that reductions in the Federal deficit are necessary in order to decrease interest rates. The FHA mortgage insurance and GNMA-MBS programs, however, rely solely on private investment funds. There are no net Federal dollars expended under these programs. Nor are there any ties to the Federal Financing Bank, as the private lender, not the Federal government, is responsible for marketing the GNMA securities to investors through securities dealers. To have any favorable impact whatsoever on financial markets, reductions in Federal spending must be real ones, not simply artificial reductions on paper.

Proposed reductions in the FHA mortgage insurance and GNMA-MBS guaranty commitment levels will not have an ameliorative effect on interest rates and on the financial markets. Even if marginally qualified home mortgage borrowers are rationed out of the markets, because they are unable to obtain mortgage financing at all, Federal deficit spending will soak up that reduced share. Thus, the real issues involved in these proposed reductions are whether the Federal government intends to reduce its commitment to housing and mortgage finance, by restricting programs that enhance the availability of adequate supplies of mortgage credit, especially for moderate- and middle-income families and first-time homebuyers, and whether these reductions signal an intent to reduce, overall, the share of credit that has historically been utilized in financing mortgages.

These issues are being addressed at a time when the demand for home mortgage credit has never been stronger. The Federal government, long ago, recognized the social need for, and importance of, housing its citizens, and responded in an appropriate manner by creating programs to fulfill this social goal. Not only have the non-subsidized FHA insurance and GNMA-MBS guaranty programs worked efficiently, but they have been profitable for the government. They have achieved a remarkable success in structuring a mortgage finance delivery system that provides readily available sources of mortgage credit throughout all phases of interest rate cycles, involving private sector lenders and investors to a maximum degree.

The real benefit enjoyed under these programs is not a subsidy, but the capital market efficiency of the GNMA security, and the standardization offered by the underlying FHA and VA loan instruments. The non-subsidized FHA mortgage insurance programs provide an unfailing source of private mortgage credit for low-downpayment, fixed-rate loans to homebuyers. The GNMA-MBS program ensures lenders of ready placement in the secondary market for FHA and VA loans. In effect, the existence of the GNMA-MBS program allows the individual consumer the same access to the credit markets as large corporate borrowers and the government.

The future of the mortgage finance delivery system is heavily clouded by uncertainty. The thrift industry is undergoing unprecedented difficulties, which undermine its capacity to provide long-term financing for mortgages. Fundamental changes in the future powers of all financial institutions are presently being debated in Congress, and those changes will undoubtedly alter the roles of many institutions that previously have been deeply involved in mortgage finance. As the role of these traditional mortgage finance institutions as a predominant source of mortgage credit is altered, the pivotal importance of the secondary mortgage market will increase, because of its ability to attract adequate supplies of mortgage credit from non-traditional, as well as traditional, investors. A lender, rather than having to procure an investor for every individual loan, now packages a number of loans in a mortgage pool. Investors need not consider the merits of the individual loans themselves, or even know anything about mortgages, but can rely instead on the proven track record of the GNMA security.

Not only is the role of primary lending undergoing radical changes, but the very nature of the mortgage, itself, is being altered. With the inflationary atmosphere and volatile interest rates of the recent past, investors are less willing to lock their funds into long-term, fixed-rate instruments. The proliferation of creative mortgage financing techniques in the conventional market inhibits standardization of the underlying mortgage instruments—a feature that is essential whenever loans are to be pooled and sold in packages as securities in the secondary mortgage market.

The GNMA-MBS is one of the most significant and successful mechanisms ever devised for attracting capital for mortgage investments. MBA believes that the continued strength of the GNMA-MBS program will assist rather than impede the development of a viable conventional MBS market, because trading in the GNMA-MBS serves to establish a benchmark for the pricing of these instruments, as well as serving as a model for the development of a conventional MBS in a market that is currently undergoing radical changes. These fundamental changes inhibit the standardization that is so necessary to investor acceptance of these types of instruments, and may retard the development of an acceptable conventional MBS format.

In summary, the actuarially sound FHA mortgage insurance programs and the GNMA-MBS guaranty program were created to foster support for homeownership and assure access to the credit markets. These programs are remarkably successful at achieving these goals, at no cost to the Treasury. However, the task is not yet finished. The 1980s represent a clear challenge to the housing and mortgage finance industries to deliver adequate supplies of affordable mortgage credit to unprecedented numbers of potential homeowners. The FHA and GNMA-MBS programs will help to address those needs efficiently, unless credit budget ceilings restrict their operations. This Congress will decide whether this Nation's commitment to housing its citizens remains one of its important goals.

With respect to the FHA and GNMA ceilings, we urge the inclusion of procedural protections in any credit budget for these self supporting programs. First, anti-impoundment protections should be included so that the congressionally approved limits cannot be rolled back by administrative fiat. Second, a system to alert the appropriate committees, if the ceilings are approached, should be instituted to give Congress sufficient time to react. Third, the procedures established for adjusting ceilings in the event they are reached should be streamlined, to avoid market disruptions. Prior to 1961, when limits were placed by the authorizing committees on FHA insurance levels, these ceilings created serious disruptions in the mortgage market whenever they were reached. Recognizing this, Congress instituted the practice of annual FHA insurance activity authorizations, but wisely discontinued the practice of setting dollar limits.

1982 AUTHORIZATION LEGISLATION FOR THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PROGRAMS

The Administration's proposals provide for funding authorizations for housing and related programs for HUD, as well as program extensions.

Following are MBA's recommendations with respect to various sections of the proposed legislation.

LOW INCOME HOUSING

Section 202 would amend the Section 8 multifamily rental assistance program by substituting a housing voucher program for the current Section 8 housing assistance program. MBA believes a program to assist the construction of multifamily rental housing, administered by HUD, is necessary to provide an adequate supply of rental housing in those areas of the country experiencing low vacancy rates. MBA urges Congress to enact a multifamily rental housing production program as part of the 1982 HUD authorizing legislation. Later in the testimony we discuss S 2171, introduced by Senators Dodd and Cranston, that is an interesting and welcome initiative in this area.

In testimony before this Subcommittee last month, MBA endorsed S 2226, the "Emergency Interest Reduction Payments Act of 1982," sponsored by Senator Lugar and cosponsored by eighteen other Senators. In order to provide a stimulus to the economy, the bill would reduce interest rates on home mortgages for homebuyers for five years through assistance payments made by the Federal government. The bill would spur construction of owner-occupied housing, but not rental housing. MBA believes that the production of multifamily rental housing can also produce a needed economic stimulus. Multifamily production requires a longer start-up time than single-family production. There are, however, two provisions Congress can enact that will permit the construction of projects that can be started in short order.

One action Congress should take that would quickly spur multifamily rental production would be to direct the Secretary of HUD, when determining fair market rents, to take into account additional costs, due to increased interest rates, incurred by projects for which contract authority was reserved during FY 1982. We suggest that the interest rate factor to be used by the Secretary be set to move with the market. MBA believes this provision is absolutely necessary for the construction of assisted housing projects that are to be financed with tax exempt bonds for which contract authority has been reserved in FY 1982. The current interest rate limit of 12 percent in the HUD regulations implementing the current FAF, a rate below current market rates in the municipal bond market, together with the regulatory requirement that construction commence by June 1st, make it doubtful that many projects will be able to go forward without enactment of such a provision as we suggest.

MBA believes that a second action that should be taken is an additional authorization in excess of $1 billion for the GNMA Tandem program. The Administration's proposal does not include a funding authorization for FY 1983 for this program. There are projects in the pipeline that could begin construction in a brief period of time if funding were available.

These projects will provide badly needed housing for low-income persons through a proven and workable financing system, as well as providing an economic stimulus.

EXTENSION OF FHA MORTGAGE INSURANCE AUTHORITY

Section 301 would extend the insuring authority for most of the FHA programs for two years. MBA supports the two year extension. Congressional practice for the past few years has been to provide for a one year extension. MBA urges this Subcommittee and the Congress to enact the two year extension of these programs as provided in Section 301 so as to diminish the possibility of FHA's insuring authority from lapsing and disrupting the markets, as has occurred in the recent past.

SECTION 235

Section 301 would extend the Section 235(i) home ownership assistance program for lower income families for one year, but would not provide additional funding authorization. MBA supports the extension and urges a modest level of funding for this program for FY 1983. The Section 235(i) program is a useful, efficient means of providing homeownership assistance to low-income families that has worked well in the past. We suggest that this program would complement the assistance program contemplated under S 2226.

PROPOSED ELIMINATION OF INSURING AUTHORITY FOR NURSING HOMES AND HOSPITALS

Section 301 does not include extensions for the FHA Section 232 nursing home and the Section 242 hospital insurance programs. The rationale propounded by HUD is that the private market can meet these financing needs for both nursing homes and hospitals, and, further, that only a very limited need exists for financing hospitals. This is simply untrue.

MBA urges the extension of authority to insure under the FHA Section 232 nursing home and Section 242 hospital programs.

Insurance written under these programs has provided a worthwhile and necessary source of financing for nursing homes and hospitals that are, for the most part, located in urban and rural areas. This has not resulted from any intentional targeting, but rather, because private entities have not provided financing in these areas where profits are not as certain and the financial risks are higher. A much higher proportion of the patients in projects insured under Sections 232 and 242 are Medicare and Medicaid recipients than in most privately financed projects. Many of FHA-insured nursing homes and hospitals offer free or reduced-cost care, because they are located in areas where the patients are largely low-income families. Obviously, this community oriented service cuts into profits. In fact, many of these projects are owned and operated as non-profit institutions by religious or other community oriented organizations. This health care would not be available without federally insured financing, which serves to lower interest costs and ensure that financing can be secured.

The Section 232 and 242 programs are not subsidized and are actuarially sound. Without the availability of these programs, many of these projects either would not be viable, or if financed, would cost more. Ironically, much of the potential added cost would be picked up by the Federal government, because so great a percentage of the patient population in these nursing homes and hospitals qualify for Medicare and Medicaid.

FREE FHA/VA INTEREST RATE

Section 304 would allow all FHA-insured mortgages to bear an interest rate and discount points agreed upon by the borrower and lender. MBA supports this section. Under current law, the maximum interest rate allowable on a mortgage insured by the FHA is fixed by the Secretary of HUD. Customarily, the Veterans Administration (VA) follows HUD's lead and sets the same maximum rate for VA-guaranteed mortgages. In the early 1950s, Congress enacted legislation to fix interest rates and to ban discount points. The result was a collapse of the FHA/VA portion of the mortgage market, and the law was repealed.

The setting of a maximum interest rate by the HUD Secretary harkens back to an earlier era in America's financial history when residential mortgage markets were highly localized and sometimes dominated by a few suppliers of mortgage credit. Possibility for abuse existed, and the Federal government, in the FHA and VA mortgage insurance and guaranty programs, acted in a fashion similar to state governments and set maximum interest rate ceilings. This Federal and state system of interest/usury ceilings was not a problem as long as market rates remained below the ceilings. However, the volatility of interest rates in the latter part of the 1970s turned this restrictive system of interest rate limitation, into a hangman's noose around the neck of the housing and mortgage finance industries.

Congress recognized this, at least as far as state mortgage usury ceilings were concerned, and preempted those laws as part of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221). MBA believes the time has arrived for Congress to complete the task of reforming the law by repealing all artificial restrictions on interest rates for FHA and VA mortgages.

The Federal preemption of state usury ceilings has been in force for two years. Only a handful of states have overridden the preemption. To date, there have been no widely reported and documented instances of abuse or charges of substantially above market interest rates by mortgage lenders. As we maintained to the Congress in testimony on this issue in 1979 and prior years, the market forces of supply and demand, together with the national linkage of all local mortgage markets, ensures that no single lender or group of lenders in any locality or region could demand and receive mortgage interest rates substantially above the market rate. The same is true for FHA and VA loans.

The Housing and Community Development Act of 1980 (P.L. 96-399) authorized the HUD Secretary to set up a negotiated interest rate demonstration program for FHA-insured mortgages and report the results to Congress by March 1, 1982. The program has never been implemented, and even if it should be, no meaningful results will be produced, for several reasons. First, the number of loans involved—the greater of 10 percent of all FHA loans insured or 50,000 loans—is entirely too restrictive in view of the way most FHA-insured loans are financed. Approximately 80 percent of all FHA loans are placed in GNMA mortgage-backed security (MBS) pools. The GNMA-MBS program requires all loans in each MBS pool to carry the same interest rate. The system is designed to operate at maximum efficiency with a high volume of loan production. The advantages to be afforded lenders by having 10 percent of all FHA-insured loans carry negotiated interest rates is too small to be worthwhile, when balanced against the existing high volume system of originating loans all carrying the same interest rate and, thus, all eligible for placement in GNMA-MBS pools.

Second, the statutory requirement of a 30 day commitment period is excessive, in light of the volatility of interest rates in the past several years. The requirement places all the risk of interest rate shifts on the lender and, thus, is an inducement for lenders not to participate in the demonstration program.

If lenders are to bear all the risk of interest rate shifts, they will have to purchase commitments for funding from investors, at the interest rate agreed upon with the borrower. The cost of purchasing the commitment would have to be recouped from the borrower, either through a fee or a higher interest rate. If for any reason the loan did not close, then the lender could very well be forced to bear the entire cost of the funding commitment purchased from the investor. Faced with this choice, most lenders will choose not to participate in the demonstration program.

This points out the difficulties and complications that result when Congress attempts, through legislation, to impose artifical restrictions on free market transactions that take place in a volatile environment. We urge Congress to enact Section 304 and remove all interest ceilings on FHA-insured loans.

MORTGAGE INSURANCE PREMIUM

Section 305 would amend the pertinent sections of the National Housing Act to exclude the amount of mortgage insurance premium paid at the time of closing from the applicable maximum mortgage amount and down payment requirements. This amendment would allow HUD, by regulation, to require FHA-insured borrowers to pay the FHA insurance premium in full at the time of settlement. According to HUD, the premium will be discounted on a present value basis based on the average expected term of the loan and will be included within the amount of the approved loan.

MBA believes this proposal merits careful consideration. MBA urges Congress to keep two features at the forefront when reviewing the Administration's proposal.

First, the Administration proposal would allow borrowers to include the lump sum premium in the mortgage balance and, thus, would preserve the low downpayment feature of FHA-insured loans that is so vital in providing affordable financing for moderate- and middle-income borrowers. Second, the Administration proposal should not result in monthly payments that are significantly higher than they would be under the present system, depending on the rate at which the premium is discounted and the average loan term that is assumed in the calculation. If an average loan term of 13 years is assumed, and if the discount rate that is used to calculate present value is the contract rate of the loan, there should be no signficant increases in monthly payments over the present system.

The Administration's proposal could cause the loan-to-value ratio to rise above 100 percent in those instances where borrowers made the minimum downpayment. However, this should not cause a significant increase in the default rate of FHA-insured loans, nor threaten the financial soundness of the mutual mortgage insurance fund (MMIF). The principal reason is that with the features outlined above, the borrower's monthly payment would not be significantly increased. It is the monthly payment, in proportion to the borrower's income, that is the key determinant of the borrower's ability to afford the mortgage. With the features outlined above, this proportion would not be altered.

It appears the interests of both the borrower and the solvency of the MMIF would be preserved under the Administration proposal. Also, HUD might realize significant administrative savings over both the present system, where lenders remit the insurance premium on a yearly basis, and the soon to be implemented system of monthly remittance for existing loans. The change, of course, would be gradual since existing loans will stay under the present system of periodic remittances. But as these loans mature and are replaced by new loans with lump sum payments, HUD's record keeping, and the expense associated with it, might diminish.

NON-OWNER OCCUPIED SINGLE-FAMILY MORTGAGES

Section 306 would amend current mortgage limits on single-family FHA-insured mortgages on non-owner occupied homes. The amendment would set mortgage limits for investor-owned dwellings at the lesser of 85 percent of the loan-to-value ratio or the same dollar amount limits as for owner-occupied dwellings. MBA supports this provision. It will encourage an increased supply of moderately priced rental housing by providing a more flexible means of financing for owners of rental housing. This proposed amendment complements the changes in depreciation that Congress enacted last summer, as part of the Economic Recovery Tax Act of 1981 (P.L. 97-34), which permit newly acquired residential rental housing to be depreciated over a maximum 15 year period. This relatively short depreciation period encourages investment in residential rental housing and the proposed amendment will complement that encouragement.

PREMIUM CHARGES FOR AMIs

Section 307 would authorize the HUD Secretary to charge different insurance premiums for alternative mortgage instruments (AMIs) that are proposed in Section 316, than would be charged for fixed-rate, level payments FHA-insured mortgages. Also, Section 307 would permit premiums charged to be in excess of one percent per year if deemed necessary by the Secretary. MBA supports this provision, provided that it is confined strictly to those experimental AMIs that would be authorized under Section 316. These AMIs may initially require higher premiums than fixed payment mortgages, because they appear to be riskier and because there is little or no actuarial experience to establish an anticipated claims rate.

MODIFICATION OF FHA DEBENTURE TERMS

Section 308 would eliminate the requirement that any debentures issued by FHA in payment of insurance claims be redeemable at par. MBA opposes this provision.

Enactment of this provision would affect the practice of many lenders who use these debentures to pay insurance premiums under the various FHA programs. It would be grossly inequitable to apply this provision to outstanding debentures. Lenders accepted these debentures in full reliance upon their being eligible for acceptance at par by HUD to satisfy mortgage insurance premium obligations. To change the rules governing the use of these outstanding debentures abruptly would be tantamount to a taking of private property without due process of law, because the existing value of these debentures would be sharply reduced.

These debentures were issued under a statutory scheme that was devised to forestall the possibility of an unanticipated high claims rate on the various FHA insurance funds at a time when the funds were not sufficiently solvent to pay all those claims in cash. Thus, these debentures are deferred claims against the various FHA insurance funds that are to be paid in full at the time the debentures mature. In the interim, these debentures pay interest at a rate corresponding to the prevailing rate on long-term Treasury obligations at the time the commitment to insure the underlying mortgage was issued.

Section 308 would permit HUD to capitalize on the effect that inflation has had on long-term, fixed-rate debt obligations in order to avoid paying insurance claims in full by making it more advantageous to pay insurance claims in debentures rather than cash. Under current procedure, if an insurance claim is paid in cash, the lender would be paid the remaining principal obligation on the mortgage, together with prescribed allowances for foreclosure costs and the like. The amount of this payment is not in any way reduced or discounted in relation to the difference between the contract interest rate of the mortgage and the prevailing market rate of a Federal debt obligation of a similar term. The reason for this is, quite simply, that the Federal government is obligated, by the issuance of mortgage insurance, to pay claims in full upon defaulted, FHA-insured mortgages.

The HUD proposal, therefore, would offer an incentive to HUD to pay insurance claims in debentures, rather than cash, since the only immediate obligation of the various insurance funds would be to make periodic interest payments at rates that could well be considerably below current market rates, until the debentures matured at some point in the future. Thus, a scheme that was devised as a temporary expedient could very well become the prevailing method of paying FHA insurance claims. In turn, this would sharply diminish the worth of FHA mortgage insurance, drive up interest rates in those mortgage insurance programs where payment by debentures was used, and eventually diminish the opportunities for affordable mortgage credit made available through FHA mortgage insurance.

Rather than enact Section 308 as proposed, MBA suggests that Congress simply abolish the issuance of debentures for all future claims against the various FHA insurance funds and mandate that these payments be made in cash. Or, alternatively, that debentures that are issued in the future carry an interest rate that is the same as the contract rate on the mortgage upon which the insurance claim is made. In this way, if HUD discounts these debentures when accepting them in payment for insurance premiums, the discount will be off of the mortgage rate, rather than the effective interest rate on long-term Treasury borrowings. We also recommend that outstanding debentures continue to be accepted by HUD at par for payment of FHA insurance premiums until all outstanding debentures mature. In this way, a program devised as an expedient will be ended in a manner equitable for all involved.

DISCRETIONARY RENT REGULATION

Section 309 would grant discretionary authority to the Secretary to regulate rents in FHA-insured, unsubsidized, multifamily rental projects, rather than mandate such regulation as current law provides. MBA supports this provision. Rent control, at whatever level of government imposes it, is a substitution of artificial price levels set by government fiat for the free market forces of supply and demand. The distortion that results inevitably works to the detriment of the tenant as the incentive for owners properly to maintain their rental projects is diminished, and potential investors are discouraged from investing in either existing or newly constructed multifamily rental housing.

MANUFACTURED HOME PARKS FOR THE ELDERLY

Section 310 would amend current law to permit the insurance of manufactured home parks designed exclusively for the elderly. MBA supports this limited exception to the current rule that requires borrowers to certify that they do not discriminate against families with children. Manufactured rental housing affords the elderly decent, sanitary accommodations at a reasonable cost. Manufactured home parks designed exclusively for the elderly can incorporate a number of design features that would have little or no appeal to families with children. MBA believes mortgage insurance should be available for these types of home parks.

SUBSTANTIAL REHABILITATION

Section 311 would amend the limits on mortgages for substantial rehabilitation of multifamily rental properties with existing FHA-insured mortgages. MBA supports this provision as a means for promoting the rehabilitation of existing multifamily rental housing and upgrading the Nation's rental housing stock. The current limit is 90 percent of the sum of the estimated cost of repair plus the existing indebtedness. Section 311 would change the existing indebtedness portion of the formula to the value of the property before rehabilitation. This provision could prove particularly useful in those cities with a rental housing stock that is basically sound, but in need of rehabilitation, by offering owners, who have maintained their properties and thus preserved the value, a more flexible means of financing the rehabilitation and refinancing the existing debt.

MORTGAGE INSURANCE FOR CONDOMINIUMS

Section 314 would eliminate the conditions contained in current law that must be met before HUD may insure mortgages on individual condominium units, and simply permit mortgage insurance on a condominium unit in a project that has been approved by the Secretary. MBA supports this provision as facilitating the use of FHA mortgage insurance for the acquisition of condominium units. This provision will permit FHA better to serve moderate-income homebuyers, who make up a substantial percentage of all condominium purchasers, by making FHA mortgage insurance more readily available for condominium purchases.

FHA CO-INSURANCE

Section 315 would eliminate the current limit on the amount of mortgages that may be insured by FHA on a co-insured basis. MBA opposes this section. There is no demonstrated need for removal of the current limitation of 20 percent of the aggregate principal amount of all mortgages insured by FHA. In FY 1981, HUD reported that less than 3 percent of all FHA mortgages were insured on a co-insurance basis. The President's Commission on Housing has also recommended against an expansion of the co-insurance program.

In addition, HUD already has in operation a viable and proven alternative to the co-insurance program—delegated processing. The President's Housing Commission has recommended an expansion of this program. Under the FHA delegated processing program, the paperwork burden, primarily checking the credit worthiness of the borrowers and obtaining the appraised value of the property, is shifted largely to the lender. The benefit to the lender for assuming this burden is a much shorter processing time for mortgage insurance. Unlike co-insurance, the delegated processing program does not require lenders to retain 10 percent of the loan. Thus, mortgage bankers, who are not depository institutions, are unable to invest directly in mortgages, can participate in delegated processing and help HUD to realize administrative savings. They cannot do the same with the co-insurance program. The fact that the features of delegated processing allow mortgage bankers to participate, while the co-insurance program effectively precludes them, is very important in light of the fact that mortgage bankers originate some 80 percent of all FHA-insured loans.

The delegated processing program, which has been on a demonstration basis in 18 selected areas of the country for the past two years, has worked extremely well. We recommend that HUD's efforts to achieve needed administrative savings and maximize the involvement of the private sector in FHA mortgage insurance programs be directed toward implementing the delegated processing program on a nation-wide scale, rather than expending limited resources on a program that effectively excludes the vast majority of the most experienced FHA lenders.

ALTERNATIVE MORTGAGE INSTRUMENTS

Section 316 would amend existing authority for HUD to insure graduated payment mortgages (GPMs) and add new authority to insure several types of alternative mortgage instruments (AMIs), including GPMs for multifamily rental projects, adjustable rate single--family mortgages, and shared appreciation mortgages (SAMs) for single-family and multifamily dwellings.

MBA supports Section 316 as a reaffirmation of FHA's historic role to serve the interests of the homebuying public by testing experimental concepts aimed at providing sufficient supplies of mortgage credit to satisfy the demand for decent, safe, affordable shelter. Under Section 316, HUD will be able to provide these embryonic alternative mortgage concepts with the standardization, uniform documentation, and market acceptability of FHA-insured mortgages. FHA's role in this respect could replicate the service the agency performed in establishing the fixed rate, level payment thirty-year mortgage as the industry norm. By offering uniform nationwide standards, documentation, and a means of financing through the GNMA-MBS, these alternative mortgage instruments can be established as viable means of mortgage finance and could then be emulated by the private sector.

MBA has three specific comments with respect to the proposed AMI insurance authority. First, we suggest that the SAM provisions be amended to permit lenders to receive a percentage of any proceeds that remain from a foreclosure sale after the existing mortgage is paid off and the owner is reimbursed for the downpayment, equal to the lender's percent of appreciation specified in the SAM. We agree that no type of FHA insurance coverage is possible for the lenders portion of anticipated appreciation. In the event, however, of a foreclosure and sale, the borrower has already had the benefit of the agreement they made with the lender in the SAM, namely a below market interest rate. It is only equitable that if there are excess proceeds that a percentage of those proceeds should be paid to the lender in return for the benefit that the borrower has already enjoyed.

Second, we suggest that flexibility be granted the Secretary with respect to the percent of FHA-insured mortgages that could be ARMs or SAMs. While the proposed limits on the number of loans 125,000 and 50,000, respectively, should prove sufficient, it is possible that these mortgage types could become extremely popular and therefore suggest that the

Secretary be permitted to increase these limits by 15 percent, should circumstances so warrant.

Finally, because state laws, regulations, or court cases restrict or prohibit certain aspects of ARMs in as many as 26 states, MBA urges the inclusion of legislative language that would preempt such restrictions or prohibitions, because their impact would ultimately diminish the broad experimental authority envisioned by this legislation. In order for any experimental mortgage programs to receive an unbiased test and gain lender acceptance, there must be nationwide standardization of the program. Additionally, there is precedent for such a preemption in the action taken in the 1977 housing act, PL 95-128, where the Congress created the GPM and overrode state statutes that would have restricted origination of GPMs.

TIME OF PAYMENT OF PREMIUM CHARGES

Section 318 would clarify that Section 530 of the National Housing Act, that requires prompt remittance of mortgage insurance premiums on a monthly basis, applies only to single-family mortgages. This has been MBA's understanding since Section 530 was enacted and we urge Congress to make this clear by enacting Section 318.

REAL ESTATE SETTLEMENT PROCEDURES ACT

Section 322 would amend the Real Estate Settlement Procedures Act (RESPA) by repealing sections 8, 9, 13, 14, 15, and 16, and by making several other minor changes.

Section 322(a) would repeal sections 8, 9, 13, 14, 15 and 16 of RESPA. Sections 13, 14 and 15 direct certain studies to be conducted and the studies have been made. Section 9 addressed an isolated instance which occurred in Texas shortly prior to the enactment of RESPA, and which reflection and experience suggest will not occur again or become a practice.

With regard to Section 8 and Section 16, which provides the courts with jurisdiction to enforce Section 8, MBA believes that this anti-kickback statute and HUD Regulation X which implements Section 8 are overly confusing and complex, have failed to reduce settlement and related costs, and, along with Sections 4 and 5 of RESPA, have even increased such costs.

In the early 1970's, with MBA's cooperation, an amendment to the FHA regulations was formulated and adopted that prohibited kickbacks in the FHA insurance programs. This regulation, 24 CFR 203.7(a)(6), appears to have worked well in the context of the FHA programs which are administered locally through area offices of an agency familiar with the varied practices of the real estate finance market. At the time Congress was first considering Section 8 of RESPA, MBA supported enactment of Section 8, believing that the favorable results of the FHA regulation would be effected over the entire market.

Experience under Section 8 has revealed its imperfections. Certain brokerage arrangements that would increase competition by easing market entry are forbidden. Those interests who object to one market operator providing more than one settlement service (so-called "controlled business") maintain that the section is too weak; those interests who would prefer to see one entity provide all settlement services (so-called "lender packaging") think that the section is too restrictive. As a Federal criminal statute, it has resulted in only one prosecution since it was enacted, and the facts reported from that case indicate Illinois state criminal statutes would have provided adequate sanctions. The intent of Section 8 of reducing settlement costs by prohibiting receipt of benefits by those who provide no service is laudable, but the section has shown itself to be a clumsy tool for the purpose, and in its current form it should be repealed.

Section 322(d) would repeal Subsection 4(b) of RESPA which requires that the person conducting a residential real estate settlement involving a federally related mortgage permit the borrower to examine the completed settlement statement the day prior to the settlement. Although not proposed by HUD, MBA urges that not only Subsection 4(b) but all of Section 4, requiring use of a HUD-prescribed settlement form, and also Section 5 of RESPA, requiring that special information books be paid for and distributed by lenders, should be repealed. Although these requirements do not place a severe burden on mortgage lenders, compliance does have its costs. More importantly, the requirements of RESPA are an unnecessary regulation of the private market by the Federal Government. MBA believes they should all be repealed.

HOUSING COUNSELING ASSISTANCE

Section 323 would eliminate all funding for grants under the Housing Counseling Assistance Program. MBA believes that housing counseling is a prudent means for HUD to safeguard the integrity of the FHA insurance funds and for the Federal government to safeguard its investment in housing assistance and mortgage insurance. We urge Congress to fund this program, even if at a reduced level, to continue this relatively inexpensive safeguard.

RESTRICTING ORIGINATIONS OF ARMS

MBA urges Congress to add to the 1982 HUD authorizing legislation a Federal preemption of those state laws that restrict or prohibit HUD-approved lenders and state-chartered, federally insured depository institutions from offering the same types of adjustable rate mortgages (ARMs) that federally chartered lenders are able to offer. Federally chartered lenders enjoy a preemption from state laws that otherwise would prohibit or restrict them from offering the full range of ARMs made available through regulations issued by the FHLBB and the Comptroller of the Currency. In prior testimony we have urged a similar preemption for state due-on-sale restrictions and have endorsed the preemption contained in S 1720, "The Financial Institutions Deregulation Act of 1981."

The effect of these state laws that restrict ARMs is pervasive. HUD-approved mortgagees and state-chartered, federally insured depository institutions in some 26 states will not be able to offer the full range of ARMs available from federally chartered lenders. (See Appendix.)

As stated earlier, in order for lenders to accommodate consumer demand for mortgage credit, a vibrant, active, nationwide secondary mortgage market is essential. In order to have such a secondary mortgage market, there must be full and free competition among lenders to produce mortgages that serve the needs of homebuyers and are attractive to investors. State laws that limit the number of lenders that can offer ARMs or mortgages with due-on-sale clauses have the opposite effect to what is needed for such a strong secondary mortgage market.

Additionally, state-chartered, federally insured thrift institutions will need the same range of flexibility afforded their federally chartered cousins in devising ARMs that will match their assets with their liabilities, if they choose to remain portfolio lenders, either in whole or part. Unduly restrictive state laws could place these institutions in a severe, unfair bind, and force them to abandon residential mortgage lending for their own portfolios.

If both Federal preemptions are enacted, lenders would be competing on equal terms for mortgage business and consumers would benefit both by having a choice of lenders and by a broader array of terms and instruments from which to choose. MBA urges Congress to include an ARM preemption in the HUD authorizing legislation as a means of helping to ensure that America's future home financing needs will be met.

FEDERAL HOME LOAN MORTGAGE CORPORATION

There are two issues MBA would like to raise in connection with the Federal Home Loan Mortgage Corporation (FHLMC). The first is S 1805, a bill that would provide for the recapitalization of the FHLMC by transforming it into a Federally chartered, privately owned, stock corporation. The second deals with the fee charged lenders, who are not members of the Federal Home Loan Bank (FHLB) system, who sell loans to the FHLMC.

FHLMC Recapitalization Proposal. The FHLMC has secured introduction in Congress of S 1805, which would authorize the restructuring of the FHLMC in order to attract additional capital for an expansion of its mortgage activities. MBA endorses the recapitalization plan of the FHLMC as a necessary step to increase the capacity of the secondary mortgage market, so that the market will be broad enough to accommodate all lenders seeking to sell mortgage loans. We urge this Subcommittee and the Congress to consider the legislation promptly. The debt-to-capital ratio of the FHLMC, because of mortgage purchase activity, and most particularly the "SWAP" programs for all mortgages, this year and in the past, promises to be at an unacceptably high level by the end of 1982, unless this legislation is enacted. A failure to do so may force the FHLMC to curtail mortgage purchases or charge all lenders who sell mortgages to FHLMC very high fees. Either action will redound to the detriment of the homebuying public, either through a reduction of available mortgage credit or an increase in mortgage interest rates.

Currently, the FHLMC's ratio of debt and contingent liabilities to capital is 51:1. At the current rate of mortgage purchase operations, and most particularly, the "SWAP" program for all mortgages, being conducted by the FHLMC, this ratio will increase to approximately 74:1 by December 1982. A debt-to-capital ratio in excess of 50:1, that is sustained for a significant period, could create serious difficulties for the FHLMC, both in the cost of short term debt necessary for their mortgage purchase operations and the acquisition of investor capital. Prompt enactment of S 1805 would alleviate this problem by permitting the FHLMC to acquire capital sufficient to reduce this ratio through the sale of stock.

S 1805 would transform the FHLMC into a government chartered, privately owned corporation authorized to purchase mortgages, to issue conventional mortgage-backed securities (CMBSs), to guarantee CMBSs issued by eligible sellers, and to treat seller/servicers on an individual basis, rather than by type or class. The legislation would permit the FHLMC to guarantee CMBSs issued by FHLMC-eligible sellers and backed by pools of mortgages, patterning its plans on the successful operation of the GNMA-MBS pools of government-insured and guaranteed loans. The stunning success of the GNMA-MBS, in part due to its liquidity, its attractiveness to a wide range of non-traditional mortgage investors, and the aggressive marketing by individual issuers, has created the impetus for the FHLMC's proposal to recapitalize and intitiate a program to guarantee CMBSs. Once this program is operational, the ability of the secondary mortgage market to supply the capital needed for America's mortgage credit needs will be enhanced substantially.

In light of the new Federal National Mortgage Association (FNMA)-CMBS program, it is legitimate to ask whether there is a need in the market for two federally chartered entities, operating similar programs. We think there is, and that the reason can be summed up in a single word—competition. The presence of both FNMA and the FHLMC will expand the breadth of the secondary market as each entity seeks to attract new investors in their CMBSs through innovative programs, aggressive marketing, and other means. For example, with the existence of two entities, neither FNMA nor the FHLMC will have the luxury of being the sole determinant of the rules of the CMBS market, and thus will be forced to work hard, not simply to adapt to changes in the market, but to anticipate those changes and to act accordingly. This constant competitive striving for that extra edge will lend a vigor to the marketplace that would be absent if only one institution existed.

This vigor will be extremely important if the conventional mortgage market is to be as successfully securitized as the FHA-VA market has been. It is true that this securitization of the FHA-VA market was done under the auspices of a single entity—GNMA. However, one very important fact must be kept in mind. The market acceptance of the GNMA-MBS and the liquidity that flows from that acceptance is in large measure due to the backing of the GNMA-MBS by the full faith and credit of the United States Government. Neither the FHLMC- nor the FNMA-CMBS will enjoy this backing, and it will be vital to the success of both that they be tailored to receive ready acceptance by investors, to assure the highest possible volume of sales, which, in turn, will generate liquidity. Competition will immeasurably aid the speed with which this process will be accomplished for both CMBSs and thus, it is vital that both FNMA and the FHLMC remain distinct entities operating in the secondary market.

It is important, though, that neither entity should have a competitive advantage because of provisions in their respective charter acts. There are provisions in S 1805 that may bestow such advantages upon the FHLMC and we urge Congress to extend equal treatment to FNMA through appropriate amendments to the FNMA Charter Act.

Non-Member Fee.

Currently, lenders who are not FHLB-system members must pay an additional fee equal to .5 percent of the balance of any mortgage loans they sell to the FHLMC. This fee is not paid by FHLB-system lenders. The rationale for the fee is that it constitutes a capital contribution on the part of non-FHLB system lenders to the FHLMC, recognizing that the FHLMC was originally capitalized by a $100 million contribution by the Federal Home Loan Banks. In enacting P.L. 97-110 last year, Congress, in removing the volume limitation on the purchase of loans one year old or older by both the FHLMC and FNMA, also prohibited the FHLMC from charging non-FHLB system members fees not charged FHLB-system members in the purchase of loans one year old or older, where the seller contemporaneously sells such mortgages and receives in payment for such mortgages securities representing an undivided interest in those mortgages.

MBA believes Congress should extend this prohibition to all FHLMC loan purchase programs. The original rationale for the fee differential has lapsed now that the FHLMC has purchased in excess of $20 billion worth of mortgages from FHLB-system lenders. If the FHLMC had been charging a .5 percent fee on those purchases, the total would have been approximately $100 million—the amount of the original capital contribution by the Federal Home Loan Banks. Thus, the FHLB-system lenders have received a benefit equivalent to their original contribution, and the rationale for a differential in the fee structure no longer exists. The FHLMC could revise the fee structure administratively, but thus far has been unwilling to do so.

If Congress decides not to prohibit a fee differential for all of the FHLMC's mortgage purchase programs, MBA urges extending the prohibition contained in P.L. 97-110 to new mortgages purchased by the FHLMC in return for FHLMC under the Guarantor mortgage-backed securities programs.

The FHLMC has announced its intention to begin purchasing new mortgages in such a manner. Mortgage banking companies do not participate in the purchase program for loans one year old or older, because mortgage bankers are not portfolio lenders and, therefore, do not own any mortgages one year old or older. Mortgage bankers sell all the loans they originate within a brief period of time after origination. However, mortgage bankers could participate in the new FHLMC purchase program, where payment for the new loans purchased will be FHLMC securities representing an undivided interest in those same loans. Mortgage bankers, and all non-FHLB-system lenders, will be at a considerable competitive disadvantage under this new mortgage purchase program because of the fee differential. The only function the fee continues to serve is to discriminate between classes of lenders and to drive up the cost of mortgage credit for homebuyers who borrow from non-FHLB-system lenders. Thus, no one is served, not the homebuyer, not lenders, and not even the FHLMC whose volume of business would be considerably larger if non-FHLB-system lenders could compete on an equal footing.

MBA urges Congress to add a provision to the HUD authorizing legislation that would prohibit the FHLMC from charging non-FHLB-system lenders different fees, under all mortgage purchase programs, than are charged to FHLB-system lenders.

MULTIFAMILY HOUSING PRODUCTION PROGRAM

Legislation introduced by Senators Dodd and Cranston, S 2171, would create a new multifamily production program, employing flexible means to provide assistance to make the production of new multifamily housing financially feasible. The assistance could be in the form of a capital grant, a loan, interest reduction payments, grants to finance the purchase of land, or other comparable assistance. The projects must be located in areas experiencing shortages of rental housing and HUD would select those projects to be assisted. At least 20 percent of the units in each assisted project would have to be occupied by families with incomes no greater than 80 percent of the median income of the area.

MBA believes that this program would encourage the badly needed production of multifamily rental housing in areas experiencing a shortage of such housing, at less cost to the Federal government than the Section 8 new construction program. We applaud the initiative of Senators Dodd and Cranston in fashioning a new program to deal with the serious problem of inadequate production of multifamily rental housing. We urge Congress to consider adding S 2171 or a similar program to the 1982 HUD authorizing legislation.

One amendment we urge to S 2171 is to permit at least half of the funds to be awarded through HUD field offices directly to developers and builders. Many local and county governments lack the staff resources and capabilities to develop housing proposals with the level of sophistication that will be needed to be awarded funding in competition with proposals from other communities. Permitting half the funds to be awarded by HUD field offices directly to developers and builders will permit housing to be built in all areas, regardless of the local government's capacity, and will take advantage of the experience that developers, builders and lenders have acquired through other HUD programs in constructing and financing assisted multifamily rental projects. Additionally, we urge all funding available to a state be awarded in this manner in those states where there is no state housing finance agency.

RESCISSION AND BUDGET PROPOSALS FOR MULTIFAMILY ASSISTED HOUSING PROGRAMS

Finally, we would like to bring to the Subcommittee's attention two Administration proposals that could sharply curtail the already low level of subsidized multifamily rental housing production.

The multifamily housing industry has been operating under the impression that the Administration was committed to funding the current 'pipeline' of multifamily housing projects. HUD Secretary Samuel Pierce, along with many Congressional leaders, have, throughout the past year, announced such a commitment and promised efforts that would enable those pipeline projects to proceed. Based on those promises, developers, in good faith, have invested millions of dollars to keep their projects alive during the last year awaiting an improved market. They currently face huge losses because they relied on such commitments to the pipeline.

Now the Administration has concluded that the Secton 8 leased Housing Assistance Program is too costly and should be discontinued after FY 1982. The FY 1983 budget proposal calls for rescission of FY 1982 Section 8 budget authority that represents the loss of over 75,000 Section 8 units for which funds have been committed.

In addition, certain HUD regulatory actions will curtail activity even for those pipeline projects that otherwise would be funded. An example of the regulatory actions being taken by HUD, which have the effect of impoundment, is the imposition of a 7.75 percent per annum cap on Section 8 contract authority increases. Many projects have been in the pipeline for several years, over which time double-digit inflation has meant that the rent expenses originally calculated for the projects would result in a lesser amount than is needed to run the project without an operating deficit. Congress should be aware that the greater increase is not needed because of cost overruns in building the projects, these projects have not yet begun construction. The increase is needed to get the projects started at a feasible level. To reiterate the point, this 7.75 percent limitation is, in effect, an impoundment of Section 8 funds because, with its imposition, projects are infeasible and, therefore, cannot go forward. If they did go forward, the operating shortfall would continue throughout the life of the project.

We urge Congress to reject the Administration's proposed rescission of FY 1982 Section 8 funds and to direct HUD to establish a more realistic cap on Section 8 contract authority increases, so as to permit the construction of those projects that that have been languishing in the pipeline. The object of the Section 8 program is to house low income people. The Administration's actions in these instances are directly contrary to this purpose.

Thank you for the opportunity to testify. I will be happy to answer any questions you may have.

APPENDIX

STATES THAT RESTRICT ADJUSTABLE RATE MORTGAGES (ARMs)

Alaska
Arkansas
District of Columbia
Florida
Georgia
Hawaii
Idaho
Indiana
Iowa
Kansas
Maine
Michigan
Missouri
Montana
Nevada
New Jersey
New York
North Dakota
Ohio
Oregon
Pennsylvania
South Carolina
Tennessee
Vermont
West Virginia
Wyoming

Source: Mortgage Bankers Association of America, March 1982

Mr. GOURLEY. Mr. Chairman, before making my remarks on the 1982 HUD authorization legislation, the subject of these hearings, I would like to comment briefly on another piece of legislation, one which is near and dear to you. That is S. 2226, the housing stimulus legislation you and other Senators have sponsored and I'd like to concur with Senator Riegle and urge that this committee resolve the differences over S. 2226 and enact a bill in order to reverse the deepening decline in housing, mortgage lending, and related industries.

As mortgage bankers, we feel that the recapture provisions of this bill cause it to fall within the category of funding that would be acceptable under our policy.

Turning now to the specifics of the administration's proposed legislation, MBA urges Congress to set the commitment ceilings in the 1982 HUD authorization legislation for the FHA mortgage insurance and GNMA mortgage-backed securities programs at $40 and $68.25 billion, respectively. The administration's bill would not set commitment ceilings in the authorization bill, however the administration's budget proposes FHA and GNMA ceilings of $35 and $38.4 billion, respectively.

Bluntly speaking, the administration's figures make no allowance for a housing recovery in fiscal year 1983, even without a housing stimulus program.

Mr. Chairman, there is a report that has just come into my hands from the GAO concerning this particular issue and I would wonder if I could get this, without having to make further comments, entered into the record. It has to do with the staff reviews on the President's fiscal year 1983 budget proposals and speaks specifically to those ceilings.

Senator LUGAR. How long is the report?

Mr. GOURLEY. There are six pages.

Senator LUGAR. Without objection, we will make it a part of the record.

[The information referred to follows:]

U.S. GENERAL ACCOUNTING OFFICE: STAFF VIEWS ON THE PRESIDENT'S FISCAL YEAR 1983 BUDGET PROPOSALS

TARGETING OF FHA MORTGAGE INSURANCE AND REDUCTION IN COMMITMENT CEILING—GAO SUPPLEMENTARY DISCUSSION

GAO views.—The administration proposes to redirect FHA home mortgage insurance to serve only those segments of the housing market—such as first-time and inner-city homebuyers—who are not adquately served by private mortgage insurers. Also, as a result of targeting FHA insurance to only these groups, the administration proposes to reduce the limitation on new insurance commitments to $35 billion for fiscal year 1983 and each year thereafter, a reduction of $5 billion per year from the $40 billion approved for fiscal year 1982.

Our ongoing work in this area indicates that the targeting of FHA insurance to groups such as first-time and inner-city homebuyers would probably not have a significant impact on FHA's operations in that it is generally these groups that FHA has been serving to a very large degree in recent years. Further, the $35 billion FHA commitment ceiling proposed for fiscal year 1983 should, under existing conditions, be sufficient to accommodate expected demand. We believe, however, that the administration's arguments for these proposals raise certain fundamental issues, particularly for the future, that the Congress may want to address:

While the $35 billion commitment ceiling is expected to be sufficient for fiscal year 1983 under existing conditions, should interest rates drop and proposals to create several alternative financing mechanisms succeed, this ceiling may prove to be inadequate to meet the increased demand. Further, retention of the commitment ceiling at $35 billion for future fiscal years would appear to be inadequate given a release of pent-up demand for housing, particularly among first-time home buyers, and increased home prices. If these limits are established below effective demand, how will available commitment authority be equitably allocated among lenders, builders and borrowers?

The non-subsidized FHA mortgage insurance programs operate at no cost to the Federal Government. They are actuarially sound, user-fee supported programs. These fees not only cover losses but also pay all expenses of administering the programs. The net income is used to build up reserves and, in the case of the Mutual Mortgage Insurance Fund (MMIF), to pay dividends to homeowners upon termination of their mortgages. As of September 30, 1981, the MMIF had reserves totalling over $2.8 billion. These funds are invested in U.S. Government securities, thus reducing the cost of borrowing to the Treasury. According to estimates projected in the fiscal year 1982 Revised Budget, if FHA was subjected to a constant $35 billion commitment ceiling, the Treasury would forego savings from these investments totalling $348 million for the fiscal years 1983 through 1986. Considering the economics of the FHA mortgage insurance programs, is it reasonable to restrict these programs at this time?

The administration claims the commitment limit is an integral component of the President's plan to control the growth of Federal credit. The FHA mortgage insurance programs in question rely solely on private investment funds and involve no Federal dollars. In fact, investment of reserves in U.S. Government securities, as previously noted, actually reduces the Federal credit demand on the private markets. How, therefore, will a reduced commitment ceiling serve to control the growth of Federal credit?

The argument that the private mortgage insurers have the capacity to increase their share of the market is valid. However, they are insurers, not lenders and are dependent upon the lenders for prividing the mortgage funds. Conventional lenders are currently encountering difficulties in providing an affordable, steady stream of mortgage funds. During periods of mortgage credit scarcity, FHA, with the readily available secondary backing of the GNMA Mortgage-Backed Securities program, is a steady source of low-downpayment, fixed-rate loans. Considering the distress of the housing market, is there adequate justification at this time for restricting FHA's home mortgage insurance programs which serve to facilitate home sales and homeownership?

REDUCTION IN COMMITMENT AUTHORITY FOR GNMA MORTGAGE-BACKED SECURITIES—GAO SUPPLEMENTARY DISCUSSION

GAO views.—In its fiscal year 1983 budget, the administration notes its intention to reduce the fiscal year 1982 commitment ceiling for GNMA Mortgage-Backed Securities (MBS) from the $68.25 billion already approved in the 1982 Appropriation Act to $48 billion. For fiscal year 1983, the administration proposes to further restrict commitments under this program to a level of $38.4 billion.

The justification for the reductions in the MBS commitment ceilings state that they are not expected to adversely affect the levels of guarantees expected to be issued in either fiscal year 1982 or 1983. The size of these reductions, however, raises some basic questions that the Congress may want to address:

Given the large reductions in commitment authority for fiscal years 1982 and 1983 and the importance of the GNMA MBS program to the FHA and VA mortgage insurance and guarantee programs, will loan originations in these programs, even under existing economic conditions, be restricted by the proposed ceilings? Should an upturn in the housing market occur in these years, and home prices continue to increase, what effect will these reduced ceilings have on the FHA and VA programs?

The level of commitments issued has always been greatly in excess of the level of securities actually issued. For example, in fiscal year 1980, $63.2 billion in commitments were issued while only $23 billion in securities were issued; in fiscal year 1981, the respective figures were $42.2 billion and $16.9 billion. These wide disparities exist since the program is designed to operate as a "market hedge" for builders and lenders, assuring them a source of financing if later needed. Reducing this "fallout" by establishing commitment ceilings nearer the levels of securities actually issued—as is proposed for fiscal years 1982 and 1983 where commitment ceilings would be established at $48 billion and $38.4 billion, respectively, with issuances expected of $28.5 billion and $32 billion, respectively—would result in no savings to the Government but would require a much more complicated allocation system to assure that commitment authority is available where it is most needed. Is such a system, with possible requirements for additional staff and regulations, anticipated?

The GNMA MBS program operates at no cost to the Federal Government. Fees charged securities issuers cover all expenses of administering the program and any claims. Net income is put into a reserve fund to cover possible future losses. This reserve fund—totalling approximately $322 million—is invested in U.S. Government securities. To the extent these reserves are so invested, the U.S. Treasury reduces its credit demand on the private capital markets and borrows at a lower rate. If the commitment ceilings restrict the GNMA MBS program, won't the Treasury forgo the savings from these investments?

The administration claims that these reductions are an effort to reduce overall Federal borrowing requirements and points to the $105 billion in outstanding GNMA securities as representing the equivalent of U.S. Treasury debt. The GNMA MBS program relies solely on private investment funds. There are no Federal dollars expended—either in the underlying FHA/VA mortgages or in the GNMA MBS—nor are there any ties to the Federal Financing Bank. In fact, as previously noted, this program actually reduces the Treasury's credit demand on the private markets. The Federal Government simply offers its full faith and credit backing which attracts private investment capital. How, therefore, will reductions in the MBS commitment ceilings reduce Federal borrowing?

A reduction in GNMA MBS program commitment authority probably will not decrease the overall supply of credit—and thus exert downward pressure on interest rates—unless the ceilings restrict activity in the underlying primary programs—the FHA and VA mortgage insurance and guarantee programs—and those rationed out of these markets are unable to obtain mortgage financing at all. Will the effect, therefore, be to reduce the share of credit utilized in mortgage finance?

The administration believes that reduced commitment ceilings for the GNMA MBS program will encourage and accelerate development of conventional mortgage-backed securities programs. It would appear that the development of the conventional mortgage-backed securities market is being impeded not by the success of the GNMA MBS program but rather by the lack of uniformity in the underlying conventional loan market itself. The market is undergoing radical changes at this time, including the development of a vast array of new mortgage instruments. Until the problems are resolved and a working conventional program is developed, and particularly now considering the distress of the housing market, shouldn't there be serious concerns over restricting the one market that does offer stability and performs a countercyclical role during economic downturns?

NEW AND INCREASED FEES IN THE GNMA MORTGAGE-BACKED SECURITIES PROGRAM—GAO SUPPLEMENTARY DISCUSSION

GAO views.—The administration proposes to increase the commitment authority application fee from the current $500 per pool package of commitments to $1,000 and to charge a fee of $250 to new issuers of GNMA securities. The stated purpose of these fees is to generate additional revenues and to reduce GNMA's competitive advantage over private sector mortgage-backed securities programs.

GAO has several comments on the proposal. First, the GNMA Mortgage-Backed Securities (MBS) program operates at no cost to the Federal Government and with no subsidy to MBS issuers. Fees currently charged securities issuers cover all expenses of administering the program and any claims thus far. Net income (in fiscal year 1981, $87 million) is put into a reserve fund (currently totalling about $322 million) to cover possible future losses. The need, therefore, for increased fees is not clear.

Second, the administration is attempting to encourage the development of the private sector mortgage-backed securities program by overpricing GNMA MBS fees and thus make the GNMA program less competitive. In effect, the administration proposes to penalize GNMA for its market efficiencies, thus subsidizing the operation of the private sector programs until they can become competitive. This could also be considered an intrustion into the market system.

Most importantly, the increased fees proposed will be passed along, in the form of higher interest rates, to the FHA/VA borrowers whose mortgages make up the GNMA MBS pools. This will add another expense for these homebuyers which combined with other changes, such as the up front collection of premiums on FHA loans, may disqualify many moderate-income buyers.

Relevant GAO Reports.—GAO is currently conducting a review of the markets served by FHA and private mortgage insurers and staff members are available to brief interested congressional committees.

Contact.—Steven J. Wozny, (426-1780).

Mr. GOURLEY. That will shorten my testimony even further.

With respect to other provisions of the bill, MBA supports section 304, which would free all FHA mortgages from restrictions on either the interest rate itself or discount points. We feel that freeing the FHA interest rate is long overdue and is a logical extension or step after the preemption of the State usury laws which now do not set a ceiling for interest rates in the various States.

MBA opposes section 315, which would remove the current volume limitation on the number of FHA loans that can be coinsured. There is no demonstrated need for the removal of these limits, particularly when a viable and proven alternative exists, which is FHA's delegated processing program, a program that all lenders can participate in; and unlike the coinsurance program that effectively excludes nondepository lenders, such as mortgage bankers who cannot directly invest in mortgages.

Authority contained in section 316 for FHA to insure a variety of alternative mortgage instruments is strongly supported by MBA. This section would return FHA to the forefront of innovation in mortgage instruments.

With respect to section 322 that repeals certain sections of RESPA, MBA urges Congress simply to repeal the entire act. That would simplify the whole works.

Turning now to two related items, MBA first urges Congress to enact a preemption of State laws that restrict the origination of adjustable rate mortgages—ARM's, as we've called them—and to approve S. 1805 to recapitalize the Federal Home Loan Mortgage Corporation.

The secondary market that is needed to meet tomorrow's demand for mortgage credit will have to be a large, liquid market that contains uniform, homogenous products. State laws, such as those that restrict origination of ARM's, prevent that sort of market and, hence, make mortgage credit more expensive and less affordable for America's homebuyers. We urge you to consider adding this preemption to the authorization legislation.

Another means of strengthening the secondary market will be prompt enactment of S. 1805, a bill to recapitalize the FHLMC. Freddie Mac, along with Fannie Mae, are critical to the ability of the secondary mortgage market to achieve the breadth and liquidity necessary to attract additional investment capital in mortgages. Freddie Mac will not be able to do this under its current structure because it is too thinly capitalized. Additional capital can be raised by transforming Freddie Mac into a privately owned, government-chartered corporation, and that is precisely what S. 1805 would do. MBA urges its speedy enactment.

The second issue that we have is the elimination of the differential in Freddie Mac's fee structure that is imposed upon lenders who are not members of the Federal Home Loan Bank System. As we explain in our statement, we believe that there's no reason for continuing a differential, particularly one that increases the cost of mortgage credit and discourages a significant percentage of lenders from participating in Freddie Mac's programs.

Thank you very much. I would be happy to answer any questions when the time comes.

Senator **Lugar**. Thank you very much, Mr. Gourley. Obviously, you have a full shelf of items here and we'll look over them very carefully since you were good enough to summarize rapidly.

Mr. Waldo, would you please testify.

STATEMENT OF ROBERT WALDO, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA

Mr. **Waldo**. Thank you. Mr. Chairman and Senator Proxmire, it's a privilege to appear here today and I thank you very much for this opportunity.

The industry that I represent is inextricably tied to housing and therefore we are as concerned as anyone else with the health of the housing industry and those industries that are directly related to housing.

Our views of the problems besetting housing today are basically no different than those of anybody else. The problems are twofold. We have a shortage of funds for mortgages and the ability of borrowers to pay for the funds that are available. With mortgage rates at over 16 percent, less than 10 percent of the prospective first-time homebuyers in the country can afford to buy that home, and this is clearly not acceptable in a Nation where 65 percent of the households own the premises that they occupy.

Our first concern then should be to get interest rates back to an affordable level. This will require reduction of Federal deficits and strict controls on Federal spending because there's no doubt that the Government's direct and indirect demands for credit impact the costs of money for all competing borrowers.

Also of vital importance is the availability of credit and along with that the ability of the housing sector to access the general capital markets. Historically, housing did not have that need. Thrift institutions collected local savings and recycled them into residential loans and thereby provided 80 percent or more of the funds that were needed for housing. They retained these loans as portfolio investments so they did not fall in the capital markets at all for that portion of housing funds.

Well, we know without elaboration what the current economic climate has done to the thrift institutions. However, we can also predict that prospectively, while thrifts will continue to be deeply involved in housing, their involvement will be in origination and servicing of loans and not as portfolio investors. That means that the long-term capital that formerly was provided by thrifts must in the future come from the general capital markets.

GNMA COUNTERPART

In the past, the only access that mortgages have had to the general capital markets has been through GNMA certificates. Those are mortgage-related securities backed by federally insured or guaranteed loans. Until the past 2 years there has been no burning need for a counterpart vehicle to market conventional loans. Well, obviously, that burning need now exists.

It's being met in part by the conventional mortgage-backed securities program that was recently initiated by FNMA and, incidentally, our industry not only heartily applauded that move but also has been very supportive of FNMA's efforts to get that program going.

Prior to FNMA's program, there have been a number of private placements of mortgage-backed securities that have been effected by affiliates of our MICA members and by other institutions. The successes of these issues I think demonstrates the conventional loans are viewed as acceptable investments by the capital markets and the conventional mortgage-backed securities will flourish, but before they can do that, they have to be given a structure that will simplify registration and sale under Federal and State securities acts and they'll have to clarify the authority of pension funds and other institutional investors to buy these securities, and legislation is needed to eliminate a number of troublesome and vexing income tax questions should more than one participant be involved in the issue of a security.

In fact, the demonstrated acceptability of securities backed by conventional loans leads to the conclusion that there is no need to reemphasize greatly the Government involvement in the insurance and marketing of unsubsidized home loans. In fact, we believe that Government involvement may now be safely reduced. We believe it should be reduced because, as I said earlier, Government credit demands, whether direct or indirect, do adversely impact the cost of money for all borrowers and we believe that Government involvement may be reduced without adverse consequences to housing.

As we point out in our full statement, the private sector has ample capacity to pick up the unsubsidized business of the FHA so that it can be redirected to its original purpose of assisting those borrowers that cannot be economically served by the private sector.

Also as pointed out in our full statement, any borrower who qualifies for an FHA unsubsidized loan would qualify for a conventional privately insured loan and given equal access to the capital markets, these conventional loans as represented by conventional mortgage-backed securities are as acceptable as mortgage-related securities as are GNMA certificates.

Therefore, we urge that action be taken to facilitate the development and the structure for conventional mortgage-backed securities and we support the administration's recommended limits for fiscal year 1983 on the insuring authority of the FHA and GNMA.

GENERAL OBSERVATIONS

With regard to specific legislation that is now pending, rather than comment on each of the bills that are before this committee and elsewhere, I would like to make just a few general observations.

First of all, don't forget the private sector. Some of the bills do provide for using conventional loans and private insurers, but others appear to provide for all subsidies and insurance going through Government programs. We believe that this would be a mistake and would unnecessarily burden Federal credit guarantees even further.

Second, we would encourage legislation allowing as much flexibility as possible to programs of FNMA and FHLMC. If it is felt that some restrictions are needed to assure that these secondary markets will be preempted by other loans and thus not available as purchase for loans for low and moderate income purchasers. However, it is imperative that other conventional mortgage-backed securities be allowed to have the same access to the capital markets so that no artificial barriers remain between housing and the capital markets.

Thank you very much, and I would request that our full statement be entered into the record. Thank you.

[The complete statement follows:]

STATEMENT OF ROBERT L. WALDO, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA* BEFORE THE SENATE HOUSING SUBCOMMITTEE IN REGARD TO 1982 HOUSING LEGISLATION.

April 14, 1982

Mr. Chairman and Members of the Subcommittee:

My name is Robert L. Waldo and I appear before you as President of the Mortgage Insurance Companies of America, a trade association of private mortgage insurance companies. Of the fifteen companies presently writing mortgage insurance thirteen are members of this Association. Our members represent a 98% share of the private mortgage insurance market.

I am also President and Chief Operating Officer of Verex Assurance, Inc. with home offices in Madison, Wisconsin. My company writes mortgage insurance in 50 states, Puerto Rico, and the District of Columbia.

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* The Mortgage Insurance Companies of America is a trade association consisting of thirteen domestic private mortgage insurance companies whose insurance-in-force on December 31, 1981 was $114.3 billion. The national officers of the Association are Robert L. Waldo (President of Verex Assurance, Inc.), Madison, Wisconsin, President; Leon T. Kendall, (President of Mortgage Guaranty Insurance Corporation), Milwaukee, Wisconsin, Vice President; William A. Simpson, (President of Republic Mortgage Insurance Company), Winston-Salem, North Carolina, Secretary; Claude E. Pope, (President of American Mortgage Insurance Company), Raleigh, North Carolina, Treasurer; and John C. Williamson, Washington, D.C., Executive Vice President.

The industry I represent is inextricably tied to housing, since mortgage insurance companies are legally restricted in most jurisdictions to a single line of business -- insuring lenders against losses on residential mortgages. From our perspective we know firsthand that the housing market has a major impact on the nation's economic well-being. We also know that housing consumes about 30% of all long-term domestic credit issued annually, and therefore is one of the most "interest sensitive" of the nation's keystone industries.

We also know that profound changes are occurring in the way home purchases are financed. All of our members are subsidiaries of, or have close ties to, major corporations through which additional financial services are provided to lenders. The principal additional service we provide is secondary marketing, or finding investors for loans originated by the insurer's lender customers; and we have seen the need for this collateral service to expand several-fold within the last five years.

Our purposes in presenting this testimony are three-fold. First, we want to tell the story of the private sector, because we believe that the capability of the private sector is often overlooked in crises such as now being experienced in housing. Secondly, we want to give you our view as to why the Administration's proposal to gradually disengage the Federal government from the insuring and marketing of unsubsidized loans deserves your support. Thirdly, we will also comment on some of the Administration's housing recommendations as set forth in a legislative draft submitted to the Congress on March 31, and as set forth in the President's Budget Message but not in the Administration's draft legislation.

Background

From the mid 1930's through the 1970's, 70% to 80% of the funds to finance housing were provided by portfolio lenders. Federal credit guarantees played a role in raising the housing capital not provided by portfolio lenders, first in the FHA loans originated by non-portfolio lenders and sold to various investors, and later through the secondary outlet provided by the Federal National Mortgage Association (FNMA), and later still through Government National Mortgage Association (GNMA) certificates distributed directly into the general capital markets.

In 1981, the FHA's $10.4 billion of newly insured unsubsidized loans represented 11% of the year's total loan originations. In 1981 GNMA's $14.257 billion of new issues represented about 15% of the year's total mortgage volume.

It is now clear that the housing finance institutions are being reforged in the current economic environment, as thrift institutions have found that the risk of wide fluctuations in interest rates precludes them from supporting an asset base made up of long-term debt with liabilities made up of short-term, volatile deposits. Hence, in the future the capital markets must provide the bulk of the funds previously available to housing through portfolio lenders, as well as that already being provided through the non-portfolio lenders.

In the most recent 50 years of development of securities regulation and the capital markets generally, there has been no need to provide a means of publicly marketing conventional loans. The need for that capability now exists, and creating the capability will require a comprehensive approach.

Whole loans are suitable investments for portfolio lenders, but are unwieldy as investments for other institutions which represent major sources of future mortgage funding. Many of these institutions now invest in GNMA certificates, not as "mortgages" but because GNMA's are de facto government securities. (See The "Crowding Out" Phenomenon below). However, the private sector has demonstrated that conventional residential mortgage loans also are now and will be favorably accepted by the general investment community. In 1979, 1980, and 1981, about $3 billion of conventional mortgage-backed securities were issued. This figure excludes activity by the government sponsored secondary market agencies. Those investors usually referred to as "non-traditional" were a small part of this conventional mortgage backed securities market. It should be emphasized, though, that "non-traditional" investors have only been minimally involved in GNMAs also.

More public offerings of conventional mortgage-backed securities have not materialized primarily because the costs associated with compliance with current securities laws and regulations requiring an issue of at least $30 million; and in a volatile interest rate environment, changing conditions may create an adverse or impossible market before the $30 million of loans can be assembled. Thus, under current federal and state securities registration laws and regulations, almost insurmountable problems stand in the way of creating a publically offerable "security" backed by conventional loans. LEGISLATION IS REQUIRED TO ALLOW CONVENTIONAL LOANS TO HAVE FREE AND ADEQUATE ACCESS TO THE CAPITAL MARKETS WITHOUT BURDENSOME AND UNNECESSARY REGISTRATION REQUIREMENTS.

Historical experience demonstrates that conventional mortgages, standing alone or in the form of a mortgage backed security, are investments of the quality and standards required by most fiduciary investors. However, despite recent positive strides, such as amendment of ERISA regulations, questions still persist under various state laws and other regulations which inhibit many potential investors from buying conventional loans or conventional mortgage backed securities. LEGISLATION IS NEEDED TO CIRCUMVENT OR SUPERSEDE RESTRICTIVE LAWS AND

REGULATIONS THAT RETARD THESE INSTITUTION'S INVESTMENTS IN HOUSING.

Given a solution to these matters, a large institution could originate conventional loans and thereafter create and market mortgage-backed securities. The small, localized lender, however, would have access to the capital market only through an intermediary, or "conduit", willing to purchase loans from diverse lenders and, in turn, convert these into securities which it would issue. Under current tax laws there is substantial uncertainty as to whether the interest paid by the borrowers on the underlying loans might not be taxed more than once. Until these uncertainties are resolved, small, localized lenders, who are responsible for a substantial majority of the mortgage originations, will have difficulty accessing the capital markets. LEGISLATION IS REQUIRED TO PROVIDE THE STRUCTURE FOR A CONVENTIONAL MORTGAGE-BACKED SECURITY WHERE THE UNDERLYING LOANS ARE ORIGINATED BY MORE THAN ONE LENDER.

Recent Developments

One major breakthrough has recently occurred in the area of conventional mortgage-backed securities, and another is being proposed.

The Federal National Mortgage Association (FNMA) has recently initiated a series of programs for the issuance of conventional mortgage-backed securities with certain FNMA guarantees. Because of FNMA's structure as a quasi-public corporation its securities are not subject to the same onerous requirements as those applicable to private companies; and because of the billions of debentures previously issued by FNMA to fund its portfolio, its conventional mortgage-backed securities will find acceptance in the marketplace. Thus many of the inhibitions to a free market listed earlier will be avoided.

Similarly, the Federal Home Loan Mortgage Corporation (FHLMC) has proposed legislation to its charter to allow it to operate programs similar to those of FNMA. FHLMC's proposed programs, like those of FNMA, will have the benefit of market accessability and investor familiarity.

However, much more needs to be done. The FNMA and FHLMC programs will no doubt produce the volume of conventional mortgage-backed securities necessary to establish the criteria which the market will accept in other similar issues. However, the two agencies historically have been subject to certain restrictions, such as limitations as to the size and nature of loans they may purchase. It is reasonable to expect that restrictions of some form will be imposed on them in the future, as Congress in the past has sought to be assured of the continued existence of a secondary market for loans made to low and moderate income borrowers. Therefore the need will remain for the legislation suggested earlier, in order to provide access to the market for all loans, whether or not of the size and type which the agencies will be allowed to purchase. And it is our hope that the private sectors concerned can agree on comprehensive legislative proposals that would provide a regulatory structure allowing all conventional housing finance to have free access to the capital markets.

Effect of Federal Guarantees on Affordability

The problems just discussed pertain to the adequacy of the supply of capital for housing. A problem of equal proportion is the ability of borrowers to afford the cost of home financing in today's economy. We suggest that the continuation -- and particularly an expansion -- of federal involvement in housing credit guarantees of unsubsidized home loans will serve to both disrupt the flow of capital to housing through conventional sources, and to increase the cost of capital to all borrowers. Accordingly, we have supported the Administration's proposals to place limits, in FY1983, on the commitment authority of both the FHA and GNMA. We believe these limitations as proposed will have no adverse effect on the availability of housing or mortgage financing, that no segment of the public will be adversely affected, and that, in fact, such limitations, as one of the many steps needed to curb the use of direct federal credit and federal credit guarantees, will help restore stability and balance to the economy.

The "Crowding Out" Phenomenon

A GNMA certificate is backed not once, but twice, by the full faith and credit of the United States Government. The underlying loans, if insured by the FHA, carry 100% federal insurance against losses on default; and if guaranteed by the Veterans Administration are protected against losses up to $27,500. The GNMA program requires loan originators to "pass-through" all principal and interest as received, and further to advance all installments on loans that may be delinquent. GNMA unconditionally guarantees the holders of GNMA certificates against default on these obligations of originators. In contrast, investors in a conventional mortgage-backed security, even though of high quality investment grade, will be protected only by guarantees issued by private sector entities, such as private mortgage insurers, private sector surety companies, FNMA, FHLMC, etc. Naturally the full faith and credit guarantee of the U. S. will be preferred by investors, and so long as there is no limit imposed on the amount of FNMA certificates that can be issued it will be difficult for conventional mortgage-backed securities to achieve their full potential. This is particularly ironic in view of the fact that FHLMC's PCs trade at 10 to 30 basis points and the new FNMA conventional security at 50 to 60 basis points over a typical GNMA yield; and other conventional mortgage-backed securities issued in the illiquid private placement market command only a 1% yield differential. By contrast, the difference in yield between a T-Bond and a AAA corporate bond of equal maturity or between a GNMA certificate and a ten year T-Bond will range from 1.0% to 1.2%.

From the foregoing, it is clear that the government's guarantee in the case of GNMA certificates does not command the same investor preference as it does in the case of other government debt securities. GNMA certificates, with the full faith and credit of the United States Government behind them, are Federal Government securities. Many investors who buy GNMA's are not doing so to invest in mortgages; they are doing so to get an extremely high yield on the safest investment in the world - debt secured by the full faith and credit of the United States Government. In 1981, GNMA issued $14.257 billion in new certificates. The U. S. Treasury issued $7.745 billion in ten-year bonds. It takes no magician to deduce that sooner or later the ten-year T-Bond yield will catch up with the GNMA yield; and since the cost of funds to the United States sets the bench mark for all other debt, it is clear that all borrowers will pay the price for the profligate use of federal credit guarantees.

Background on the Private Mortgage Insurance Industry and its Operations

In addressing these issues this Subcommittee must naturally be concerned with the private mortgage insurance industry, its structure, its financial capacity and the market it serves.

There are now fifteen companies writing mortgage insurance in what has become a highly competitive industry. Our assets aggregate approximately $2 billion, and our financial solidity is based on a contingency reserve which, on an aggregated basis at December 31, 1981 was approximately $1 billion. These reserves are accumulated by contributions of 50% of every earned premium dollar into a ten year reserve which cannot be withdrawn without the approval of the state regulator and then only if losses exceed 35% of earned premiums.

Since its creation in 1956, the private mortgage insurance industry has insured over 3 million loans; the bulk of its business has been written in the last 12 years. At December 31, 1970, the industry had insurance in force on approximately $7.3 billion of loans; that figure increased to over $114 billion at December 31, 1981.

Indicative of the role of the private mortgage insurance industry in today's housing market is the record of 1981. According to a March 12, 1982 HUD release, in 1981 $97.3 billion of 1-4 family home mortgages were closed, of which $10.4 billion or 11%, were FHA insured; and $7.5 billion, or 8% were VA guaranteed. Private mortgage insurers insured $18.7 billion or 19.2% of all originations, which was more than the FHA and VA combined.

Since the industry's inception in 1956, it has consistently scored a record growth as compared with the FHA's unsubsidized programs. Of course, in 1956 the FHA insured 100% of all loans insured. By 1970 private industry insured 12% of all insured mortgages. This increased to 53% in 1981. The only periods between 1970 and the present when the FHA's business grew faster than the private industry's were in 1974 and again in late 1979 and early 1980, when mortgage interest rates rose to exceed state usury limitations. FHA loans continued to be made during those periods even though the FHA fixed rate also exceeded the state's usury limits, because the FHA's operations are not subject to state laws. Since March, 1980, when state usury laws were pre-empted by Federal regulation, the private industry has consistently increased its market share of insured loans.

The Market Served by Private Mortgage Insurance Companies (MIC)

The Subcommittee should be aware of the market which the private industry serves and how it compares with that served by the FHA's unsubsidized home mortgage insurance programs. A comparison follows, based upon 1981 data, to show current performance between the insuring activities of private mortgage insurers and the basic FHA 203(b) program. Unlike previous years FHA does not have available, at present, data for the last two quarters of the previous year. Therefore, the following statistics are based on the available FHA and MIC data for the first two quarters of 1981.

During this six months, 36% of our insurance involved 95% loans. In that time only 33% of loans in the basic FHA program, section 203, involved a downpayment of 5% or less. The average downpayment for our industry was 12%; for FHA section 203, 11%.

In the first half of 1981, 53% of the mortgages we insured were for less than $50,000. At the same time, 59% of FHA section 203 mortgages were less than this amount. Our average mortgage in 1981 was $51,640; the FHA's, $44,528. In comparing averages, the Subcommittee should bear in mind two important facts: (1) private insurers are not subject to any mortgage limit, while the FHA is subject to limits that range from $67,500 to $90,000; and (2) 35% of the mortgages we insure are on higher priced new construction while the FHA's percentage for section 203 new construction during the first two quarters of 1981 was 16.7%.

With respect to credit underwriting standards, ours are not materially different from those the FHA applies to its unsubsidized programs. For example, we qualify a family if housing expenses do not exceed 33% of gross income; the FHA uses 35% of net effective income, or income after taxes. While the results of applying a pretax or after tax formula might be significant in individual cases, generally, there is little, if any difference in the family income requirements to purchase a home under either program.

The risk characteristics of loans insured under the FHA unsubsidized program and loans insured by an MIC are very similar. We insure the risk portion; that is, the top 20% of a 90% mortgage and 25% of a 95% mortgage. Our experience over the past two decades proves that this level of insurance is adequate for protection of both the originator and the secondary market investor. Recently some members of the industry have offered 100% coverage in response to certain investor requirements, particularly related to mortgage pools forming the collateral for mortgage-backed securities.

Urban Core Area & Low Income Borrowers

Invariably, an important issue raised in considering a redirection of the FHA's unsubsidized home mortgage insurance programs is the extent private insurers serve the urban areas. In 1981, 32% of privately insured mortgages involved homes located in urban areas, 61% in the suburbs and the balance in either rural or resort areas. Under the FHA section 203 program, using HUD's own statistics, in 1981, 55% were located in the urban areas, 42% in the suburbs, and 3% in rural. However, definitions of "urban areas" are not consistent and "urban areas" can be so diverse economically that it is difficult to draw a valid comparison.

We noted that HUD breaks the urban statistics into "core city" and "other urban". In the core city, we note that the FHA's volume here was 2% of total insurance. Unfortunately, I cannot at this time give you comparable statistics from private insurers. I can tell you, however, that the private industry has actively supported a large number of Neighborhood Housing Service Corporations (organized under the Community Reinvestment Act) both by way of financial assistance to meet their operating needs and in insuring loans with their respective projects. For example, our industry insured 6,857 mortgages in the revitalization of the Philadelphia urban areas where the loans averaged $17,500 in 1976 to $22,500 in 1980. We are advised by lenders participating in this Philadelphia Plan that the FHA was only minimally involved.

Private insurers have not penetrated the low income market to any appreciable degree, but neither has the FHA. For example, during the first two quarters of 1981, 2% of the mortgages we insured involved families earning less than $12,000 a year. The FHA 203 program, which breaks at $11,000, shows 0.4% penetration of this low income group using the mortgagor's claimed income which is closest to the "gross income" which we use. These figures, I submit, are not an indictment of either the FHA's unsubsidized program or the private mortgage insurance business. Rather, it is an indication that, due to today's home affordability problem, loans to borrowers below certain income levels cannot be prudently insured in an actuarially sound program. Insured loans for these borrowers can only realistically be provided through a subsidy program which reflects Congressional policy as to application of resources to be devoted to subsidies. However, these facts rebut arguments that the FHA unsubsidized programs, not private mortgage insurers, serve low income families.

OUR INDUSTRY WAS CREATED ON THE EXPERIENCE OF THE FHA, AND OUR SUCCESS IS A TESTIMONIAL TO THE CONTRIBUTION MADE BY THIS AGENCY SINCE ITS INCEPTION 48 YEARS AGO. ALL AVAILABLE DATA DEMONSTRATE THAT THE PRIVATE MORTGAGE INSURANCE INDUSTRY AND THE FHA UNSUBSIDIZED PROGRAMS NOW SERVE ESSENTIALLY THE SAME MARKET. WE BELIEVE, THEREFORE, BASED ON THE CAPACITY WE HAVE BUILT SINCE THE INCEPTION OF THE INDUSTRY TWENTY-FIVE YEARS AGO, THAT A REDIRECTION OF FHA'S UNSUBSIDIZED ROLE TO AREAS OF THE MARKET NOT SERVED BY PRIVATE ENTERPRISE WOULD NOT ADVERSELY IMPACT THE AVAILABILITY OF HOUSING TO ANY SEGMENT OF THE MARKET.

Industry Capacity to Absorb the FHA Market

I just made the point that our industry has the capacity to absorb the FHA unsubsidized home market, and I would like to expand on that with specific data. In 1979, this industry's unused insurance capacity was $36.8 billion. If the FHA had insured no mortgages that year in its unsubsidized mortgage programs, our industry could have absorbed this market and had $16 billion of unused authority remaining. As of December 31, 1980, our unused insurance capacity was $51.4 billion. I am attaching, as an appendix to this statement, a table showing how the industry insuring capacity is computed. 1981 statistics will not be available for another month.

FHA Premiums

The Administration has recommended changes in the FHA premium collection process. Loan servicers are now required to remit insurance premiums to HUD on a monthly basis as collected from the mortgagor. Beginning in fiscal year 1983 a revised insurance premium collection structure is recommended. This would take the form of a single-premium paid at settlement which would represent the discounted present value basis of the premium for the average expected term of the loan. HUD estimates this single premium would be approximately $1,500. To lessen the impact on the homebuyer, this premium would be built into the mortgage. We believe that the Administration's recommendation merits the support of the Congress because, as noted below, it is more consistent with prevailing insurance business practices.

In making an informed judgement on this provision, the Subcommittee should know how the private mortgage insurance industry handles premium collections. Like other insurance companies, annual premiums are paid in advance at settlement.

Most of the lenders doing business with private companies are also HUD-approved mortgagees. These have no difficulty remitting the premiums in advance because the insurance is conditioned upon receipt of the premium. Most of our premiums are based on annual renewable policies with only the lender having the option to cancel the policy. The premiums for the second and subsequent years are received from the lenders who have escrowed 1/12 of the annual premium for each month beginning with the first monthly payment on the mortgage.

While premium plans vary among the companies, a popular premium plan involves 1/2 of 1% for the first year of a 90% loan and 1% on a 95% loan. The premium on all loans for the second and subsequent years is 1/4 of 1% on the declining balance, whether the loan is 90% or 95%. While mortgage insurers are legally obligated to renew these policies annually, the lender may cancel the insurance at any time. Generally, the insurance is cancelled when the principal balance reaches 80% of original appraised value. The FHA mortgage insurance premium is 1/2 of 1% for each year and the insurance must be maintained over the life of the loan.

Private insurers also make available 5, 10, and 15 year single premiums and these are payable in advance at settlement. However, under existing insurance, savings and loan and banking regulations these premiums may not be included in the mortgage, especially if the loan is already up to 95% of appraised value.

We believe if these regulations were changed so the borrower could amortize his premium over a long term with his mortgage, it may facilitate more first-time home purchases.

The FHA Counter-Cyclical Myth

It is argued that the FHA is available throughout the business cycle and therefore must be maintained without any cap, as a counter-cyclical device. This is not a valid argument. Every month for several years, with the exception of the first two months of 1980 when FHA reaped the benefit of its exemption from state usury laws, private mortgage insurers have insured more mortgages than the FHA. Even during the 1973-75 recession our industry insured more home mortgages than the FHA.

According to a Congressional Staff Study dated November 24, 1981 comparing FHA section 203(b) with private insurance, CBO noted as follows:

> "FHA-insured mortgages outstanding declined during the 1973-75 recession, while MIC mortgages outstanding grew, but at a slower rate than during the rest of the decade."

In 1981, certainly a depressed housing year, private mortgage insurers insured 353,466 mortgages on 1- to 4-family homes, more than FHA (175,052) and the VA (142,180) combined.

As pointed out earlier, affordability is a more pressing problem than availability of funds; and the record demonstrates that an FHA insured loan is no more or less affordable than a conventional, privately insured loan. Any counter-cyclical argument of necessity must center around GNMA, because GNMA certificates, as government securities, are always marketable. We have already made our case for questioning the appropriateness of allowing government securities to be issued where no funds are raised for direct government purposes; and we have also made a case for the ability of a conventional mortgage-backed security to suffice in the capital market, given that the structure is provided to allow these securities free access to the market. In light of these considerations, we believe there is no basis for retaining either agency purely as a counter-cyclical mechanism, or for allowing the FHA-GNMA combination to continue to substitute for the private sector mechanism that is at hand and that will adequately serve the same purposes.

Redirection of the FHA

According to the President's Budget Message, the Administration proposes to redirect FHA's unsubsidized home mortgage insurance programs to first time homebuyers and inner cities. We strongly recommend that the Congress support this recommendation.

This redirection of the FHA to first time homebuyers and inner cities is not reflected in the language of the Administration's bill. However, it is our understanding that HUD intends to comply with the Administrations program by means of regulations which will be proposed during the next fiscal year.

This redirection is consistent with the recommendation of the Task Force on Housing Credit Programs of the President's Housing Commmission (subsequently approved by the Commission) as follows:

> "In view of the development of a strong private mortgage insurance industry, FHA should increasingly complement, rather than compete with, the private market. Further reliance upon the private sector in the insurance of home mortgages should be spurred by public policy designed to redirect the FHA program. FHA should operate on an economically sound basis to provide mortgage insurance only where the private market is unable or unwilling to do so."

Specifically, the Administration's Budget recommends limiting FHA's operations to first time homebuyers and inner cities. While the redirection is commendable and we support the redirection, we do not concede that our industry is unable to serve first time homebuyers and inner cities. We are active in both market areas. Thirty-six percent of our insurance in 1981 involved 5% downpayments and these were principally first time homebuyers. Thirty-six percent of our insurance in 1981 represented 127,248 first time homebuyers; yet in all of the FHA home mortgage insurance programs, the agency in 1981 insured 175,052 mortgages. If two-thirds of these were first time homebuyers, our industry assisted more first time homebuyers in 1981 than the FHA.

The low downpayment first time homebuyer does not represent a neglected market. According to the Primary Mortgage Market Survey of FHLMC dated March 19, 1982, the percentage of lenders offering 95% loans during the week ending March 19 increased sharply to 63.4% from 52.5% the previous month.

We are pleased that our industry continues to play a predominant role in assisting first time homebuyers. It is not lack of a willing lender or of a willing insurer that prevents more first time buyers from entering the market, however. It is apparent that the real villains are high interest rates and the resultant affordability problems which continue to bar many first time homebuyers from the market, regardless of the source of their mortgage insurance. These problems must be addressed by legislation which is now pending before this Subcommittee which would help bridge the affordability gap through interest rate subsidies.

FY1983 Authorizations of FHA and GNMA

For the current fiscal year, the Administration recommended $35 billion for the FHA's mortgage insurance authority. However, the Congress was persuaded by arguments that this reduced level would be harmful to housing. As a result, this limit was increased to $40 billion. According to HUD's current budget summary, the original request of $35 billion would have been more than adequate, as HUD now estimates that the FY1982 commitment level is not expected to exceed $28.6 billion. This estimate appears reasonable, as in calendar 1981 the FHA's total insurance written was $16 billion, of which $10.4 billion involved unsubsidized, single family residential loans.

We recommend approval of the Administration's request for $35 billion commitment authority for FY1983.

The Administration's request for a $35 billion cap for FHA mortgage insurance authority is premised on a desire to redirect FHA's unsubsidized home mortgage insurance authority -- which now comprises about 80% of the agency's activity -- to areas of the market not served adequately at this time by the private sector. We strongly urge the Subcommittee not to assume that this redirection will constitute a disruption of the mortgage market at this time when the housing industry is in a recession. The private mortgage insurance industry has the capacity to assume most if not all of the present FHA home mortgage insurance activities as explained in detail later in this statement. Furthermore, in considering the adequacy of the FHA's $35 billion cap for FY1983, note that private insurers insured 50% more mortgages than the FHA in calendar 1981, and the total dollar volume of mortgages insured by our industry was $18.7 billion - about half of what the Administration has recommended for the FHA.

With respect to GNMA we have no reason to doubt the adequacy of the Administration's request for a $38.4 billion limit on the GNMA-MBS program. In calendar 1981, GNMA issued commitments totalling $34.543 billion, and new issues of certificates totalling $14.257 billion. Its commitment authorization for FY1982 was $68.2 billion. Clearly, GNMA's currently authorized commitment level is far in excess of its actual requirements.

It has been argued that a high ceiling on GNMA's authorization allows GNMA to issue commitments to mortgage originators without concern for exceeding its own commitment authority or the need of setting up a commitment allocation system; and in turn, that mortgage originators, with almost unlimited access to GNMA commitments, have more flexibility to approach the market. However, as pointed out in an earlier section of this statement, GNMA certificates are government securities, and as such have parity in the minds of investors with those securities issued to raise funds used by the government for government purposes. We suggest that issuance of $17 billion in FY1981 of government securities for non-government purposes put pressure enough on the cost of other government and non-government borrowing; the prospect of issuing another $25.5 billion of such securities, matching GNMA's commitments issued, only added uncertainty to the market; and issuing another $51 billion to match GNMA's total commitment authorization of $68 billion would have created chaos. We suggest that a fair and equitable system of allocating GNMA commitments, along with a reasonable cap on its commitment authority, will allow for more orderly forecasting of the amount of securities to be issued, without danger of an "accident" occuring that would flood the market with GNMAs, thus disrupting the market for other government securities.

We believe that a redirection of FHA's activity as the Administration recommends, with a simultaneous reduction in GNMA authority, will avoid the crowding-out phenomenon which occurs when government and non-government securities seek to tap the same reservoir of capital. Investors will always prefer securities which are backed by the full faith and credit of the United States. However, the unlimited availability of Federal full faith and credit on mortgage-backed securities is bound to impede the growth of conventional mortgage-backed securities issued by private companies, FNMA and the FHLMC, all of whose securities are not Federally guaranteed. The unlimited availability of Federally guaranteed mortgage securities competing in a market of limited capital is bound to not only crowd out non-government paper but exert pressure on the cost of funds borrowed by the government, thus adversely impacting interest rates and the rate of inflation.

We believe that the Congress should support the Administration's efforts to impose some restraint on the growth of Federal credit, and insofar as restraints are placed on the FHA and GNMA, we believe that this can be accomplished without any disruption of the housing market, even during the recovery which we expect in 1983.

We urge the Subcommittee to recognize that proliferating Federal loan guarantee programs prevent effective control of government borrowing; and are a major factor in generating upward pressure on interest rates. High interest rates depress all sectors of the housing market and are paid for by all borrowers including those obtaining Federally-guaranteed loans. The Administration deserves your support in its efforts to carefully evaluate the credit needs of FHA and GNMA and all guarantee programs.

This concludes our testimony. We appreciate the opportunity of making known our views, and I welcome the opportunity to respond to any questions.

CAPACITY OF THE PRIVATE MORTGAGE INSURANCE INDUSTRY TO WRITE ADDITIONAL INSURANCE

Capacity to write additional insurance determines the amount of new insurance that can be written at that point in time without adding to existing policyholders reserves. Policyholders reserves are a key estimate and using state insurance commission definitions, are made up of uncommitted contingency reserves and policyholders surplus.

State mortgage guaranty insurance laws prohibit exposure (risk) from exceeding 25 times total policyholders reserves (capital). Using this limit of 25 and multiplying it by total policyhodlers reserves will provide an accurate estimate of the industry's total risk writing capacity. Private mortgage insurance, however, is used where needed to insure the risk portion of the loan. Typically, policies will cover the top 20 to 25 percent of the principal balance of the loan at origination. Based on industry data, the average risk portion of all loans is approximately 22 percent. Thus, to estimate the loan insuring capacity (expressed in terms of the face amount of the loans) one would multiply the industry risk writing capacity by 4.55 (1 ÷ 0.22).

In the following table, row (1) is the aggregate Policyholders reserves. Row (2) is row (1) multiplied by the statutory limit of 25 and shows total risk writing capacity. Row (3) is the actual risk in force measured for the respective years. To obtain row (4), the excess insuring capacity at that year end point, subtract row (3) from row (2) and then multiply by 4.55. The excess insuring capacity is expressed in terms of the aggregate dollar volume of insured mortgages.

Industry Insuring Capacity (dollars in billions)

		1975	1976	1977	1978	1979	1980
(1) Policyholders Reserves	$	.468	.583	.753	.952	1.132	1.276
(2) Risk Writing Capacity	$	11.7	14.6	18.8	23.8	28.3	31.9
(3) Actual Risk in Force[1]	$	8.8	10.6	13.9	17.0	20.2	20.6
(4) Excess (Unused) Insuring Capacity	$	12.6	18.0	22.4	30.9	36.8	51.4[2]

[1] Although statutory limit for the risk-to-capital ratio is 25 to 1, MICs operate more conservatively. The actual risk-to-capital ratio over the past 5 years has been approximately 18 to 1.

[2] For comparison purposes, total mortgage commitment authority by the FHA during fiscal year 1981 was $16.1 billion including single and multi-family, subsidized and unsubsidized. (Page H-29 FY1983 Budget (HUD) Summary, February 1982)

Although the above table shows a significant growth rate of excess capacity, it is important to note that this estimate is unbounded. The industry has substantial ability to create new insurance capacity. Capacity can be created not only by increments from operations (premium and investment income) and from the prepayment and repayment of insured loans, but importantly, can come from the infusion of new capital. This last source is especially revealing when one considers the assets of the holding company, parents of most individual mortgage insurance companies.

MICA/3-23-82

Senator **Lugar**. Mr. Pryde, please go ahead.

STATEMENT OF HARRY PRYDE, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOMEBUILDERS, ACCOMPANIED BY ROBERT D. BANNISTER, SENIOR STAFF VICE PRESIDENT; AND JIM SCHUYLER, STAFF VICE PRESIDENT, AND LEGISLATIVE COUNSEL

Mr. **Pryde**. Thank you. Mr. Chairman and Senator Proxmire, my name is Harry Pryde. I'm a homebuilder from Seattle, Wash. I'm testifying on behalf of the more than 114,000 members of the National Association of Homebuilders.

Mr. Chairman, since November 1981, NAHB has suffered a loss of over 9,000 members. NAHB is a trade association of the Nation's homebuilding industry, of which I am first vice president. Accompanying me today are Robert D. Bannister, senior staff vice president and Jim Schuyler, staff vice president and legislative counsel.

[The complete statement follows:]

STATEMENT OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS
before the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
on
THE ADMINISTRATION'S HOUSING PROPOSALS
APRIL 14, 1982

Mr. Chairman and Members of the Subcommittee:

My name is Harry Pryde, and I am a homebuilder from Seattle, Washington. I am testifying today on behalf of the more than 114,000 members of the National Association of Home Builders (NAHB). Mr. Chairman, since November of 1981 NAHB has suffered a loss of over 9,000 members. NAHB is a trade association of the nation's homebuilding industry, of which I am First Vice President. Accompanying me today are Robert D Bannister, Senior Staff Vice President and Jim Schuyler, Staff Vice President and Legislative Counsel.

I appreciate the opportunity to present our views on the Administration's housing proposals for 1982. Mr. Chairman, let me begin by briefly commenting on your housing/jobs stimulus bill and our hope for its immediate consideration by this Committee. We recognize the concerns you have raised about broadening the program to the point where its jobs impact would be diluted and the likelihood of acceptance by the Administration would be reduced. Let me make our position clear. We believe strongly that rapid implementation of this legislation is essential to recovery in the housing sector which would help improve the overall national economy this year. We believe that the final bill which emerges from Senate and House consideration should contain provision for adjustments in mortgage and income limits for high-cost areas. We have been persuaded by the Chairman's reasoning that inclusion of existing housing under this program would substantially reduce the jobs impact, which is after all the primary purpose of the program. There are other ways, such as tax credits, to more productively deal with problems of existing home sales. We urge this Committee to restore a bipartisan commitment to housing and jobs and move rapidly on this much needed legislation.

Before I comment on the specifics of the Administration's proposal, I would like to outline for the Subcommittee some detail, the state of the housing industry today.

HOUSING PRODUCTION

- New housing production in 1981 totalled 1.1 million units as against an annual need for new homes that has been estimated conservatively at 1.8 million units throughout the 1980s. Last year was the worst housing production year since 1946.
- 1982 could finish as the worst post-war production year yet. NAHB's optimistic forecast for this year holds annual production to about one million. Housing starts in February fell to a seasonally adjusted annual rate of 953,000, down 26 percent from a year earlier, and down more than 52 percent from the 2 million annual production levels in 1977 and 1978 February was the seventh consecutive month that housing starts were below the one million annual level.
- February is the 38th month of recession in housing. The previous record was set during the Eisenhower Administration when the housing recession lasted 27 months.

NEW HOME SALES

- 1981 was the worst year for new home sales since the Census Bureau began collecting statistics in 1963. Only 437,000 new homes were sold, compared to 545,000 homes in 1980 and more than 800,000 in 1977 and 1978.
- Since March 1981, annual new home sales rates have been under the 500,000 level. In February of this year, the annual sales rate of new homes was 336,000. This was only slightly above the record low monthly rate of 335,000 in September.
- Actual sales in February nationwide were 21,000 new homes -- roughly the monthly number of new homes that were sold in the West alone during 1978 and 1979. In all of the Western states, only 7,000 new homes were actually sold in February. Only 6,000 new homes were sold in the Northeast and North Central states combined.

INTEREST RATES

- Conventional mortgage interest rates now average 17 percent. Mortgage rates at such high levels price the vast majority of potential buyers out of the market.
- Interest rates normally fall rapidly and decisively during recession, but in this downturn they have declined slowly and have remained in an historically high range. Analysts forecast that mortgage rates are not likely to drop below 15 percent this year, thereby killing off any chances for a housing recovery in 1982. The consensus is that home sales will remain at depression levels until mortgage rates drop to the 12 percent range, which by historical standards still represents an extraordinarily high cost of home financing.
- By reducing interest rates from 16 percent to 12 percent, 4.6 million additional families could qualify for a $65,000 mortgage. At 12 percent interest rates, more than 22 percent of the nation's families have the $35,000 income needed to qualify for a modest $65,000 mortgage. At 16 percent rates, fewer than 14 percent have the $44,000 income needed to qualify for the same mortgage amount.

UNEMPLOYMENT

- Unemployment in the construction trades in February was 18.1 percent or 928,000 unemployed workers, accounting for 10 pecent of the total unemployed work force. Another 200,000 skilled craftsmen could lose their jobs over the next several months.

- An estimated 200,000 self-employed people in construction-related businesses have either shut down or sharply curtailed their operations in the housing industry. Self-employed people are not counted in the Labor Department's unemployment statistics.
- Bankruptcies are up 51 percent for construction firms and 65 percent for subcontractors.
- Rising joblessness toward levels not experienced since the 1930s continues to feed the federal deficit. The Congressional Budget Office estimates that every 1 percent increase in unemployment costs the Treasury $25 billion -- $19 billion in lost revenue and $6 billion in new expenditures to pay for unemployment programs.

Mr. Chairman, these statistics show with no uncertainty the critically depressed state of our industry. Unless and until mortgage interest rates are reduced to affordable levels, our industry will not show any signs of recovery. I am sure this Committee is aware that in the past seven recessionary periods it has been the housing industry that has led the overall economy out of recession.

SINGLE FAMILY HOUSING

Regarding FHA single family programs, we recommend the following:

1. 235

Mr. Chairman, NAHB supports a one year extension of authority for the HUD Section 235 homeownership program. The program authorization expired on March 31, 1982. There is currently sufficient authority available for approximately 10,000 units of housing production under Section 235.

I commend the efforts made by members of this Committee to extend Section 235 before the Easter recess, but hope that rapid agreement can be reached with the House -- at least on a temporary extension. Such an extension will provide immediate jobs and housing for lower-income homebuyers.

2. Floating FHA Rate

The negotiation of interest rates between borrower and lender has always provided free market pressures for affordable interest rates. Likewise, such negotiation eliminates the frequency of exceedingly high discount points at loan closing. For these reasons, NAHB supports the Administration's proposal for floating FHA interest rates.

3. Operative Builder

The FHA operative builder program provides much needed relief for reducing for sale housing inventory during periods of sudden increases in interest rates. The nonoccupant provision in HUD Section 203(b) permits builders to purchase inventory units at the FHA rate and rent the homes. This temporary relief from high conworkably low maximum mortgage amounts. NAHB supports the increase of the maximum non-owner occupant mortgage limits under Section 203 (b) to the lesser of $67,500 or 85 percent of the maximum owner occupied Section 203(b) limit.

4. Mortgage Insurance Premiums

The Administration has proposed a change in collection of the mortgage insurance premium for FHA-insured loans to a lump sum paid at the time the loan is closed. The lump sum would equal the present value of monthly mortgage insurance premiums paid by borrowers over the life of the loan. Keeping in mind that affordability is the most frequent barrier to homeownership today, NAHB would support this change only if it does not result in significantly higher monthly mortgage payments. This may require the inclusion of the mortgage insurance lump sum as part of the loan. If these adjustments were made, NAHB would support this change in the interest of the fiscal responsibility of the insurance fund.

5. Condominiums

To promote housing affordability, the marketplace is responding by the increased production of condominium housing. In the past, the burdensome regulatory hurdles of the HUD Section 234 condominium insurance program have prevented its extensive use. Currently the program requires that one of the following conditions be met: 1) the project is FHA insured or VA approved; 2) there are less than 12 units in the project; or 3) if the building has 12 or more units, it is more than a year old. The elimination of these requirements would speed processing and promote a lower-cost housing opportunity for many young families and elderly.

6. Subdivision Approvals

Consistent with the deregulation proposal in Section 234, NAHB strongly urges Congress to require total reciprocity for subdivision appprovals by the three federal housing agencies, HUD, VA and FmHA.

These agencies often have substantially identical requirements, but force developers through the expensive and time consuming process of submitting subdivision papers for an already federally approved subdivision. This recommendation is consistent with the Administration's proposal for reciprocity of FHA and VA approvals for the purpose of correcting or compensating for structural defects.

7. Alternative Mortgage Instruments

The role of HUD is to provide leadership in developing better ways to finance housing. In this regard, NAHB supports the proposal to develop an FHA adjustable rate mortgage and an FHA shared appreciation mortgage. These programs are being proposed on a limited basis, and rightfully so, because no alternative instrument should be permitted to squeeze out the standard FHA fixed rate 30 year mortgage. The fixed rate long term mortgage is still the preferred method of homeownership by housing consumers, and FHA role is essential to preserving such a mortgage instrument.

As the limited alternative instruments grow in use, they will expand if successful. An example is the Section 245 (b) graduated payment mortgage program which we strongly supported once its inception. The Administration has proposed to merge Section 245 (a) and (b) into a single, low down payment program not restricted to first time home buyers or buyers who could not otherwise finance a home. There would be no limit on the aggregate number of Section 245 loans made in any year. NAHB welcomes this step as an example of HUD developing a new program and then expanding it to meet the needs of housing consumers.

8. Coinsurance

Lender participation is a trend which could increase in the future. In addition to the shared appreciation mortgage, the coinsurance program is a very useful method of permitting lender equity as well as delegating processing. The removal of the 20 percent cap on the number of coinsured loans compared to the aggregate volume of FHA loans should allow the program to proceed at its needed pace for multifamily housing as well as single family housing.

9. FHA/GNMA Credit Programs

As we have stated before this Subcommittee on numerous occasions, the FHA and GNMA programs are essential elements of an overall national housing policy. The FHA insurance programs provide a countercyclical mechanism for moderating the periodic slumps faced by the housing industry, such as the current 40 month depression. During these periods of tight credit, FHA activity increases in percentage share of insuring one to four family homes. During periods of credit availability, the private mortgage insurance companies regain their majority share of the home insurance market. For this reason, FHA should be a demand oriented program, able to operate to its fullest extent as a counter-cyclical tool.

Likewise, GNMA provides the necessary guarantee for a secondary market for FHA mortgages which has the most activity during periods of tight credit. This counter-cyclical mechanism is a safety net for home mortgages during periods when lenders must sell their home mortgage portfolio. GNMA must be preserved as a demand oriented program.

MULTIFAMILY RENTAL HOUSING

Regarding multifamily production, I believe that the most significant action that could be taken to create jobs and stimulate construction would be to push out the HUD and Farmers Home pipeline as quickly as possible. I am referring to Section 8, Section 202, Section 515, tandem and public housing construction. Mr. Chairman, I recognize that this would represent a change in direction for the Administration. But the pipeline is the only source of production that could move this year and have an impact on employment and the overall economy.

It is our understanding that there are over 160,000 units in the Section 8 pipeline alone. Some 35,000 units are reserved for state housing finance agencies and would be financed by mortgage revenue bonds. With continued high interest rates, the projects would need a sufficient financing adjustment factor in order to be financially viable. In addition, some 33,000 units of housing for the elderly and handicapped have direct loan commitments under the Section 202 program. Almost 5,000 units should be developed in rural areas under the Section 515 rural program. Finally, most of the remaining units with FHA-insured mortgages will need GNMA tandem financing in order to proceed.

Beyond the stimulus effect of moving the pipeline, such action would keep faith with commitments made by HUD to owners and developers. Based upon these commitments, project sponsors have allocated funds toward development of final working drawings, engineering costs and other pre-development expenses. Pre-development fees typically fall in the range of $200,000 to $300,000 per project, and much higher fees are common for large, urban projects. These brave souls have labored through the time-consuming and expensive process of bringing a government-assisted housing proposal to fruition.

1. Section 202

Mr. Chairman, the Section 202 direct loan rental production program for the elderly and handicapped should continue to be funded at the FY'82 level of 17,000 units with the interest rate set at 9 1/4 percent. Section 202 projects benefit needy elderly and handicapped renters and are developed by non profit sponsors. NAHB believes that

the development of Section 202 projects could be made more efficient by opening up development opportunities to profit motivated sponsors whose experience will save valuable time and money. Likewise, Section 202 housing production should not require non profit sponsors to initially go through a competitive bidding process to select a developer. The Administration's proposal to require open bidding will add greatly to the costs of projects in the form of preliminary development of plans. This cost will be passed on to the housing consumer and taxpayer.

2. Financing Adjustment Factor

The Section 8 pipeline refers to Section 8 projects in which applications for rental assistance units have been made but for which there is no sufficient financing mechanism available to close the projects. Essential for meeting the goals of the National Housing Act is the provision of adequate financing mechanisms for those well planned projects which are viable, that is, economically feasible over a reasonable development period.

The financing adjustment factor (FAF) is one method for bringing viable projects to construction. The FAF provides a way to accommodate violent upward fluctuations in interest rates. By using FAF, the proposed Section 8 rent schedule is increased to achieve feasibility for Section 8 projects as if the financing were still at the interest rate present when the project application was first made. The increased allowable interest rate cannot exceed 12 percent. To utilize the FAF, a sponsor must increase his cash equity in the project by a percentage amount equal to the increase in allowable interest rate. Currently the FAF is operative through June 1, 1982. Given the fact that many project developers were notified just days ago that they lost out in the GNMA tandem lottery, the June 1 deadline fails to provide a reasonable period in which to pull together an acceptable financing package. Because of the persistent high level of interest rates, the 12 percent current maximum allowable interest rate under FAF is insufficient and would force the sponsor to absorb the up front cost of approximately 20 discount points. Therefore, NAHB recommends an extension of the FAF deadline to the end of FY'82 and an increase in the maximum allowable interest rate under FAF to 14 percent.

The FAF must be adequately funded to operate properly. Approximately $3.9 billion would be sufficient to provide viable projects with financing to go to construction. As Section 8 contract authority is recaptured to fund the FAF, funding delays can be relieved by permitting the use of 1982 Fair Market Rents which more accurately reflect current costs.

3. 7.75 percent limit

The current restriction on Section 8 contract authority increases is 7.75 percent each year. This limitation is inadequate in areas where construction costs have increased more rapidly over the past year.

Mr. Chairman, a telephone survey of multifamily develpers shows that in some high cost urban areas, 9 out of every 10 projects will be killed due to the 7.75 percent restriction. The 7.75 percent restriction should be raised and made more flexible.

4. GNMA Tandem

For a majority of projects, the GNMA Tandem program is the most efficient method of financing. The Administration projected a year ago that $3.6 billion of GNMA Tandem funds would fund out the pipeline for FY'82. The actual FY'82 GNMA Tandem appropriation of $1.97 billion has been used through the selection process just completed on March 15, 1982. An emergency supplemental appropriation of at least $1 billion in FY'82 would go far toward moving out the pipeline and could be funded out of recaptured FY'82 budget authority.

5. Rental Rehabilitation Grants

The proposed Rental Rehabilitation Grant program is an excellent free market solution for bringing substandard rental housing back on line. The $5,000 matching grant addresses the affordability problem by a projected use of rental assistance in conjunction with the rental rehabilitation units. States and communities are encouaged to suggest that the proposed 30,000 unit level of operation is insufficient to even start to meet the rehabilitation needs of low and moderate income neighborhoods in this country.

6. Allocation

The repeal of Section 213 would eliminate the metro/non-metro (80%-20%) allocation formula for all HUD funds. This repeal would give HUD more discretion in placing funds where there is a need. However, we are concerned that an equitable allocation of funds continue to be provided for non-metro areas particularly given the proposed deep reductions in the FmHA program.

7. Alternative Multifamily Instruments

The Administration proposals for graduated payment and shared appreciation multifamily mortgages are sound ideas on a limited basis. The track records of both programs should be monitored closely. Inflation will very likely have a great effect on how developers and lenders view these alternatives.

8. Operating Subsidies and Section 236

Operating subsidies for troubled projects should be retained for noninsured projects. Although HUD has no insurance liability for these projects, there is a federal government commitment to the tenants of noninsured subsidized rental projects. Likewise, Section 236 authorization should be extended with the ability to use these funds for troubled projects.

9. Maximum Multifamily Mortgage Amounts

To permit the maximum production of multifamily rental housing, the maximum unit mortgage amounts should be increased at the discretion of the Secretary beyond the current 175 percent limit.

10. Rent Control

NAHB supports the immediate deregulation of rent schedules for Section 221 (d) (4) nonsubsidized projects. This deregulaiton should be accompanied by the federal preemption of local and state rent control legislation. Investment in multifamily rental production has continued to plummet in rent controlled areas.

Mr. Chairman, pursuant to the recommendation of the President's Commission on Housing, NAHB urges that Congress require States electing to receive federal assistance for housing to file certified plans with HUD detailing a strategy and time frame for eliminating rent control. Any rental housing financed by a federally assisted lender, including pension funds, should be preempted from being subject to any state or local rent control.

11. Modified Section 8 Existing Housing Assistance

Rent vouchers will be most useful on a limited basis in conjunction with the rental rehabilitation grant program. However, rent vouchers do not promote new construction. Without a new production program, rental housing for low and moderate income people will simply not be built in this country.

12. Delegated Processing

NAHB supports all efforts to expand delegated processing of multifamily housing applications as the best method for speeding development and saving money.

13. New Production Program

Senators Dodd and Cranston have cosponsored S.2171, a program to stimulate the development and rehabilitation of affordable multifamily rental housing. Under the proposal, states and communities may apply for funds which can be used as capital grants, loans, interest reduction payments, and whatever other creative forms of assistance devised to assist developers in reducing the cost of rental projects. For 15 years, 20 percent of the units would have to remain available for tenants whose incomes are at 80 percent of the median area income and below. Project selection criteria will include: 1) degree of reduction of rental housing shortage 2) public and private contributions that reduce project cost 3) contribution to neighborhood develpment and mitigation of displacement 4) extent of recapture of assistance by federal government 5) applicant communities' past performance in meeting assisted housing needs, and 6) the maximization of units for the least cost.

This proposal has many strong points and should be pursued. The key to success is the reasonable assurance to the developer that funds will be available for development. In the current housing crisis, funding decisions cannot be subject to local political pressures which are not in the best interests of housing. A mechanism must be developed to shorten the time in which an application is submitted and the funds are approved or denied. The urban development action grant program has successfully minimized the financial risk taken by a developer who participates in a community's application for funding. Without such a streamlined process, no developer will invest the time and money necessary to build rental housing. Additionally, the 15 year low income availability restriction should be shortened in order to make multifamily investment more attractive.

RURAL HOUSING

Mr. Chairman, over 200 rural builders came to Washington last month representing many other builders who could not afford the trip. Their message was simple and direct -- the Farmers Home Housing programs represent the only source of mortgage credit in over half of the counties in rural America. FmHA is the only effective delivery system of mortgage credit for many rural areas. The Administration's proposed FY'83 budget for these programs bring them one step closer to elimination. It seems clear that FY'84 would see the end of the Section 502 and 515 programs, with no alternative method of financing being proposed. Proposals to convert the construction programs of FmHA into a housing block grant administered by the state disregard the workability of these programs and the generally effective delivery system in place through FmHA offices. As shown in the following chart, the proposed cuts by the Administration would decimate these essential programs.

	FY'82	FY'83 Proposed	% Cut
Section 502 Single-Family Low Income	$2.3 billion 67,500 units	$900 million 20,000 units	61%
Section 502 Moderate	$429 million 11,700 units	- 0 -	100%
Section 515 Rental	$940 million 29,400 units	$200 million 5,740 unis	79%
Rural Rental Assistance	$398 million 30,740 units	$185 million 6,830 units	54%
Total New Units	108,600	25,840	67%

Mr. Chairman, we strongly support a level of funding for rural programs that would essentially maintain the FY'82 funding levels. In addition, we support a sufficient level of rental assistance funds to make Section 515 production feasible.

Mr. Chairman, we are deeply troubled by any proposal to shift FmHA interest credit subsidies to block grants for states. We are concerned that the level of assistance being considered would be insufficient to reach a threshold of workability. States will be under political pressures to fund housing in certain rural areas. Small increments of each block grant will be channelled to areas with insufficient expertise to effectively develop or rehabilitate housing. We urge you to very carefully consider the dismantling of a rural housing and credit delivery system capable of producing more than the 100,000 housing units delivered in FY'82.

CONCLUSION

Mr. Chairman, we in the housing industry are truly at the mercy of Congress and the Administration at this critical time. What is needed is immediate passage of legislation, such as the Chairman's bill, that addresses the current crisis in housing and the economy. I am encouraged that this Committee has begun to recognize the need for an affirmative, effective national commitment to housing. You should be proud of the outstanding work of this Subcommittee's staff - both majority and minority. We look forward to working with you and with your staff -- as rapidly as possible -- to fashion a viable legislative package. I am most grateful for the opportunity to appear before you today, and would be pleased to answer any questions you may have.

Senator Lugar. Thank you very much, Mr. Pryde.

Mr. Smith?

STATEMENT OF C. O. SMITH, PRESIDENT, C. O. SMITH INDUSTRIES, ON BEHALF OF THE MANUFACTURED HOUSING INSTITUTE

Mr. Smith. Thank you, Mr. Chairman.

My name is C. O. Smith, Jr. I am chairman of the board of C. O. Smith Industries, Inc. of Atlanta, Ga., and I'm chief executive officer of Peach Tree Homes. We have home manufacturing plants in Georgia, Louisiana, and Texas. I'll do my best to summarize in 5 minutes, but please keep in mind I only speak Southern. [Laughter.]

I'm here today representing MHI and the Coordinating Council on Manufactured Housing Finance of which I'm vice chairman. I submitted a written statement to the subcommittee which addresses a broad range of manufactured housing issues raised by this year's budget and housing proposals. I'll briefly discuss the industry's position on those issues and the administration's bill which relate to manufactured housing and suggest several changes in that bill which we think will help you in achieving your housing goals and then I'll touch on the legislative initiatives before this committee aimed at assisting the housing industry.

The manufactured housing industry is sensitive to the difficult issues under consideration by this committee and Congress. While you're faced with a great need to control the Federal deficit and trim Government expenditures, it's also apparent that the housing industry needs help.

The industry supports the administration's efforts to get the economy under control in order to reduce inflation and lower interest rates, measures which will assure a prosperous housing industry. At the same time, the present housing crunch requires an immediate but measured response by the Federal Government to provide short-term assistance to keep the industry alive until the President's economic recovery program takes effect.

Let me turn to the specific proposals contained in the administration's bill which relate to manufactured housing.

[Complete statement follows:]

Statement of C. O. Smith, Jr., Chairman of the Board of C. O. Smith Industries, Inc., Atlanta, Ga., for the Manufactured Housing Institute and the Coordinating Council on Manufactured Housing Finance

Mr. Chariman and members of the Subcommittee, my name is C. O. Smith, Jr. I am Chairman of the Board of C. O. Smith Industries, Inc. of Atlanta, Georgia. I am here today representing the Manufactured Housing Institute (MHI), a national trade association representing individual manufacturers and suppliers in the manufactured housing industry. I am also appearing on behalf of the Coordinating Council on Manufactured Housing Finance (the Coordinating Council), of which I am Vice Chairman. I am accompanied today by Walter L. Benning, President of the Manufactured Housing Institute, and by Harvey E. Weiner, Washington, Counsel to the Coordinating Council.

The Coordinating Council consists of three leading manufactured housing trade associations whose members include manufacturers, retailers, park operators, lenders, developers, and state associations. These three groups have joined together to work more effectively to obtain improvements in both federal and conventional manufactured home finance and secondary market programs. In addition to MHI, the Council's members include the National Manufactured Housing Federation, a group of some 30 state and regional associations of retailers and park owners, and the Western Manufactured Housing Institute, which represents 130 suppliers and 28 manufacturers comprising 65 to 70 percent of manufactured housing shipments in the Western states.

My comments today will specifically address provisions in the Administration's proposals for the Department of Housing and Urban Development as they affect manufactured housing. Also, I would like to touch on the various other housing proposals before the Committee.

Briefly summarized, we offer the following comments on the Administration's bill:

We endorse Section 304 of the Administration's bill which expands the Department's authority to allow for negotiated interest rates for both the Title I and Title II Federal Housing Administration (FHA) insurance programs.

We support Section 310 of the Administration's bill to permit FHA insurance for manufactured home developments designed exclusively for the elderly.

We support the concept of the Administration's proposed rental rehabilitation grant program which provides for greater flexibility and wider discretion to state and local governments in providing rental rehabilitation assistance to individual property owners. We would urge, however, that such a rental rehabilitation program expressly include provisions for the rehabilitation of rental manufactured homes and manufactured home rental communities.

We are pleased that the Modified Section 8 program proposed by the Administration incorporates recent amendments to the Section 8 program to include rental assistance for rental manufactured home-and-space and for rental spaces only.

We support Section 319 of the Administration's bill which removes certain restrictions to the National Housing Act in order to provide for Section 203(b) insurance for property located on Indian reservations. We would also urge that the Administration seriously consider manufactured housing as a more effective and less costly approach to providing Indian housing assistance.

The manufactured housing industry would urge the Committee to consider the following amendments to the Administration's proposals:

The Title II FHA single- and multi-family housing insurance programs should be amended to include real property combination manufactured home and lot loans which meet the requirements of the National Manufactured Home Construction and Safety Standards Act of 1974.

The manufactured home finance programs of the FHA and the Government National Mortgage Association (GNMA) should be preserved and protected from future federal credit reductions.

The Administration's research authorizations should include authority to develop a model manufactured housing zoning code, and the Committee should urge HUD to implement provisions of the 1981 Budget Reconciliation Act which gives HUD the authority to develop a demonstration project utilizing lower cost building technology for projects located in inner-city vacant lots.

Title I manufactured home loan insurance authority should be expanded expressly to include previously owned manufactured homes.

Title I FHA manufactured home loan limits and combination home-and-land loan limits should be indexed to the Section 203(b) loan limits in order to utilize the automatic adjustment features of that program.

Authority similar to that which was authorized for the Federal National Mortgage Association (FNMA) in the Housing and Community Development Act of 1980 (P.L. 96-399) should be granted to the Federal Home Loan Mortgage Corporation (FHLMC) for the purchase of manufactured housing personal property loans and credit sale finance instruments.

State laws which limit or prohibit creditors from entering into or enforcing adjustable rate manufactured housing loans or credit sales as well as due-on-sale provisions inhibit housing investment. An alternative adjustable rate federal lending program should be available to lenders who are restricted by such laws.

With regard to the various housing stimulus proposals before the Committee, we urge you to include provisions for the financing of manufactured homes, single- and multi-sectional, both with and without land.

MANUFACTURED HOUSING IN TODAY'S HOUSING MARKETPLACE

Before I proceed further, I would like to provide you with an overview of the manufactured housing industry. I believe it is extremely important that the Subcommittee understand the prominent position that manufactured housing occupies in the current housing market.

For purposes of clarification, the terms "manufactured housing" and "manufactured home" as used in this statement refer to those homes built in conformance to the National Manufactured Home Construction and Safety Standards Act of 1974 (42 U.S.C. § 5401 *et seq.*) (HUD Code). As you will recall, the product name was changed from "mobile home" to "manufactured home" by Congress in the Housing and Community Development Act of 1980.

Congress has recognized the importance of manufactured housing on numerous occasions in recent years. This Subcommittee in particular and its counterpart in the House have repeatedly taken the lead in expanding the range of finance and secondary market programs available to potential manufactured home owners and lenders through the programs of FHA, FmHA, GNMA and, most recently, FNMA.

During 1981, over 240,000 new manufactured homes were sold in the United States. In these days of very high interest rates, these homes provide the only form of affordable home ownership for many people. It should come as no surprise that manufactured housing today comprises over 80% of all homes sold for less than $40,000.

Loan terms under these programs and under conventional finance programs can now extend up to 30 years. Increasingly, the distinctions are being erased between manufactured home finance and traditional site-built home finance. In this and other areas, manufactured housing is approaching parity with other forms of housing.

Similarly, the old distinctions with respect to the nature of ownership interest and zoning constraints are breaking down. In many states, when a manufactured home is attached to real estate through some form of permanent foundation, and the home and lot together are owned by the same party, the home is eligible for treatment as real property for taxation, titling and other legal purposes. In virtually all states in the West, this now has been made clear as a matter of specific state law. In the state of California, for example, all manufactured homes are taxed as real estate whether they are on fee owned or leased land.

As a result of these developments, there is a strong movement, particularly in the West, toward the development of manufactured housing subdivisions of tracts. Also, the use of manufactured housing for city lot infill purposes has attracted growing interest.

In addition, the old zoning barriers which effectively have kept manufactured homes off residential lots have begun to break down. Legislatures and court cases in states such as Michigan, New Jersey, Indiana, New Mexico, and Vermont have struck down restrictive zoning practices that discriminated against manufactured home owners. For example, last year, the California legislature enacted far-reaching legislation to require local communities either to permit manufactured homes attached to permanent foundations on any residentially zoned lot or to make reasonable alternative treatment available to manufactured housing (California Senate Bill 1960). This law became effective only last July.

Despite the promise of these recent developments, most manufactured housing continues to be sold and financed as personal property on a retail installment loan basis.

NEGOTIATED INTEREST RATE

Now let me turn to the specific proposals in the Administration's bill. The Housing and Community Development Act of 1980 authorized limited demonstration authority for negotiated interest rates for the Section 203(b) mortgage insurance program. This authority is expanded by Section 314 of the Administration's proposal to include Title I manufactured home loan insurance. We strongly support this expansion since we believe that competition in the marketplace will serve to regulate interest rates more effectively than the imposition of artificial rate ceilings by FHA.

The manufactured housing industry supports the concept of negotiated interest rates for FHA loans, based on our experience that artificially mandated interest rate ceilings have no real effect on borrowing costs to consumers in the marketplace.

MORTGAGE INSURANCE FOR MANUFACTURED HOME PARKS FOR THE ELDERLY

We commend and support the Administration's proposal contained in Section 310 to amend Section 207(b)(2) of the National Housing Act to permit the insurance of manufactured home parks designed exclusively for occupancy by the elderly. Activity in the Section 207 program has been very limited in spite of an intensifying shortage of park spaces. Further, where the social and economic goals of a community may call for multi-family projects designed exclusively for elderly tenants, existing law would prohibit FHA from providing insurance for such a project.

Elderly occupants account for a significant portion of all occupied manufactured homes today. Estimates range in the 30% area. Further, Dr. Thomas E. Nutt Powell, of the MIT-Harvard Joint Center for Urban Studies, in his book, "Manufactured Homes, Making Sense of a Housing Opportunity" (1982, Auburn House Publishing Company), concludes that, "the attributes of [manufactured homes] and [manufactured home communities] appear positive in terms of the shelter, financial and social needs of older people."

The Administration's proposal will enable local communities to make freer choices regarding the housing needs of their elderly citizens by eliminating constraints that do not consider the special needs of this growing segment of the U.S. population.

RENTAL REHABILITATION PROGRAM

The industry supports the flexible nature of the rental rehabilitation program proposed by the Administration. The broad discretion given to state and local governments in providing rental rehabilitation funds to individual property owners should increase the efficiency of the program, and help more low income tenants.

Last year, Congress recognized the need in some areas of the country for manufactured home-and-space rental developments. Being aware of the benefits these homes and projects could bring to federal rental construction and rehabilitation programs, legislation amended the Section 8 program to authorize HUD to contract for rental assistance with owners of rental manufactured homes and owners of space rental developments (Sec. 329H, Omnibus and Reconciliation Act of 1981, P.L. 97–35). In addition, an amendment in the Economy Recovery Tax Act of 1981 (Sec. 201(h)(3), P.L. 97–34), which provides certain capital cost recovery benefits to investors of rental manufactured homes is further evidence of Congress' recognition that manufactured housing may partly fulfill our nation's growing need for affordable rental housing.

In view of the new, more flexible rental rehabilitation program being proposed, the industry urges that it be made clear that manufactured homes and rental manufactured housing communities (where both the home and space are rented, or where only the space is rented) are eligible projects. This is in keeping with the policy of last year's legislation and with this bill's laudable aim to provide flexibility and local determination.

MODIFIED SECTION 8 EXISTING HOUSING PROGRAM

The Modified Section 8 Certificate Program incorporates recent manufactured housing amendments which provide assistance for rentals of manufactured homes with spaces and for rental of spaces only. The flexibility of the voucher approach should make manufactured housing more easily available to eligible participants and provide them with housing options that may be more cost effective than other available types of housing.

INDIAN HOUSING

The industry supports Section 319 of the Administration's bill which removes certain restrictions from the National Housing Act in order to provide for Section 213(b) insurance for property located on Indian reservations. This should provide additional needed financing options for Indian housing.

The Congress and the Administration should focus on manufactured housing as a viable housing option. Manufactured housing is particularly well suited for use on Indian reservations because of its affordability and transportability.

The Coordinating Council on Manufactured Housing Finance recently conducted a survey of the use of manufactured housing on Indian reservations and concluded that there is growing interest from Indian tribes, state housing agencies and the industry in using manufactured housing more extensively if certain problems can be overcome.

We would be glad to work with the Committee and HUD to identify problems in greater detail and to develop solutions so that manufactured housing can be a realistic housing alternative on Indian reservations.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA)

We are extremely pleased with the Administration's decision to request continuation of the mortgage-backed securities program at GNMA. We strongly support the continued availability of this important secondary market resource for fiscal year 1983 and subsequent years.

Because manufactured housing is a major source of affordable housing for first-time home buyers, the elderly and low- to middle-income families, the federal finance programs involved with manufactured housing should be preserved from significant credit cutbacks. Any further efforts to reduce the ceiling on the federal credit programs must insure that those programs specifically directed toward the most affordable housing options are spared.

The GNMA mortgage-backed securities program provides the only organized secondary market for traditional credit sale-financed personal property manufactured homes. In today's mortgage market, few lending institutions are willing to tie up funds in fixed-rate, long-term loans to be held in their portfolios. In addition, many mortgage bankers—who have played a major role in financing manufactured homes—cannot afford to hold loans in their portfolios without the ability to sell them in the secondary market. If the GNMA mortgage-backed securities program did not exist, those lenders not willing or not able to hold manufactured housing credit sale instruments in their own portfolios would be driven from the manufactured home finance market. Therefore, we urge that the FHA manufactured housing insurance program and the GNMA mortgage-backed securities program be insulated against any credit reductions.

RESEARCH AUTHORIZATIONS

Section 303 of the Administration's bill authorizes $20 million in fiscal year 1983 and "necessary sums" in fiscal year 1984 for HUD's Research and Technology programs, and we support proposed strategies for reducing component costs of housing. We would specifically urge that the Committee enact legislation, as it did last year, to develop a model zoning code for manufactured housing. That the time is right for the promulgation of such a code is recognized in HUD's "Fourth Report to Congress on Mobile Homes," the draft recommendations of President's Commission on Housing and recent State Supreme Court decisions.

In addition, we hope that the Committee will urge HUD to implement an amendment to the 1981 Budget Reconciliation Act to develop a demonstration program using lower cost building technology for housing projects located in inner-city vacant lots. We believe that manufactured housing could be an effective, cost efficient housing resource for use in such urban settings.

Now, Mr. Chairman, if we may, we would like to recommend for the Committee's consideration a number of specific amendments to the Administration's fiscal year 1983 Housing Authorization bill.

FHA TITLE II INSURANCE PROGRAM

We strongly support the continuation of the FHA Title II, Section 203(b) program for basic home mortgage insurance. You may recall, Mr. Chairman, that the Coordinating Council last year testified in support of your bill, S. 1702, the FHA Revitalization Act of 1981.

The industry strongly supports provisions in S. 1702 which would establish, on a permanent basis, that manufactured housing built in conformance to the HUD Code and affixed to a permanent foundation would be eligible for financing under Section 203(b) of the National Housing Act.

It has long perplexed us that used manufactured homes have been eligible for Section 203(b) financing while new manufactured homes, though built in the most modern fashion, have not. This is an anomaly which we believe has been without justification. While we commend the steps HUD has taken to alleviate this situation, we believe that legislation would be extremely useful because it would make clear, once and for all, that manufactured homes are intended by Congress to be eligible for Section 203(b) financing.

Also, the industry supports similar provisions qualifying HUD Code manufactured homes on permanent foundations for all the FHA's single-family and multi-family loan insurance programs. We would urge, particularly, that manufactured homes not be arbitrarily excluded from these mortgage insurance programs on the basis of unit type (i.e., single- or multi-section) or size.

FHA TITLE I INSURANCE PROGRAM

Currently, FHA Title I regulations prohibit the insuring of loans for existing manufactured homes unless the homes were previously financed under Title I (24 C.F.R. § 201.510). We believe that this regulatory restriction may not be required by the

National Housing Act. Accordingly, to remove any possible ambiguity that may exist concerning this point, we urge the Subcommittee to consider an amendment to the National Housing Act specifically authorizing Title I insurance on loans for the purchase of existing manufactured homes, regardless of how they were previously financed. Such an amendment, we believe, would be consistent with the objectives of the Administration's proposals to "maintain and enhance the Department's (HUD) capacity to contribute to achievement of the national housing goal of 'a decent home and a suitable living environment for every American family'."

The Title I program has served the manufactured housing industry and manufactured home buyers well since its inception, and we support the continuation of this vitally important manufactured home loan insurance program. The importance of the Title I program cannot be overemphasized. Title I is a co-insurance program where the lenders share the risk of loss with FHA. In return for risk sharing, the lenders are permitted to do their own loan underwriting and processing with substantial delegated authority. For this reason, and because the FHA Title I staff has an impressive working knowledge of the intricacies of manufactured home finance, the Title I program has operated efficiently, with minimal red tape. This has led to substantial cost savings for both lenders and the government.

Today there is a large stock of quality-built existing manufactured homes. We believe that this existing stock of affordable housing should be effectively utilized and that steps should be taken to make new means of financing available. Further, we think this initiative conforms to Secretary Pierce's statement of HUD's intention to emphasize the use of existing housing stock in the Department's housing programs.

INDEX FOR FHA TITLE I MANUFACTURED HOME LOAN LIMITS

We recommend that the Subcommittee consider the establishment of an index for FHA Title I manufactured home loan limits, keyed to the Section 203(b) mortgage limit, which would allow for automatic adjustments without the need for repeated amendments to the statute.

The Housing and Community Development Act of 1980 established an indexed ceiling for FHA Section 203(b) mortgages. The maximum mortgage amount for a single-family residence is not to exceed $67,500 or, at the discretion of the HUD Secretary, the lesser of 133⅓ percent of the basic limit ($89,978) or 95 percent of the area's median home sales price. As a result, FHA Section 203(b) mortgage limits are permitted to follow the housing price trends more closely from area to area without the necessity of returning periodically to the Congress for legislative amendments.

FHLMC MANUFACTURED HOUSING LOAN PURCHASE AUTHORITY

The industry recommends that authority similar to that granted to FNMA be granted to the FHLMC for the implementation of a manufactured housing loan and credit sale instrument purchase program.

While the GNMA mortgage-backed securities program has been a highly successful secondary market program for manufactured housing finance instruments, the program is limited to FHA-insured and VA-guaranteed loans and credit sales. Today there is no organized secondary market for conventionally financed manufactured home credit sale instruments. Authority to establish such a program was granted to FNMA in the Housing and Community Development Act of 1980. We are working with FNMA and we hope that such a program will be forthcoming.

Given current and proposed federal credit program cutbacks and the need for greater private housing market programs, the establishment of secondary markets for manufactured home personal property loans takes on added importance.

ADJUSTABLE RATE LENDING PARITY FOR MANUFACTURED HOME LENDERS

We support the Administration's proposals, contained in Section 316, to expand the Secretary's authority to insure mortgages using alternative financing mechanisms. We would like to see the authority expanded to include a broader spectrum of the market than is now authorized or would be authorized under these new proposals.

The manufactured housing industry has a unique interest in the development of finance programs that afford maximum creditor flexibility. This derives from the industry's traditional involvement with personal property finance, and more recently with real property finance and the combination of the two (depending upon the type of transaction and the characterization of manufactured homes under state law). No single finance option will necessarily be the best for all categories of products in all circumstances. We, therefore, believe that adjustable rate loan and credit sale instruments will be a key form of innovative finance for meeting the needs of consumers and the manufactured housing industry.

We believe that a ready source of funds for manufactured housing finance is necessary to meet the nation's need for affordable housing. For many families, particularly first-time home buyers and the elderly, manufactured housing is the only form of affordable housing. Because manufactured housing must compete with traditional site-built housing for limited funds, comparable finance instruments and credit terms must be made available to manufactured housing or it will be at a competitive disadvantage with typically higher priced site-built housing.

Unfortunately, the Administration's adjustable rate financing proposals apply only to homes insured under Title II of the National Housing Act. While there are legislative and regulatory proposals currently under consideration by the Congress and HUD that would authorize Title II financing for certain manufactured homes, most would still be financed under the Title I program. We, therefore, urge the Subcommittee to extend this adjustable rate finance program insurance authority to loans and credit sales insured under Title I of the National Housing Act as well as to those insured under Title II.

Although we applaud Section 316's innovative proposal for adjustable rate finance FHA programs, we are concerned that the entire program may be of little benefit because the laws of a large number of states work to prohibit or severely restrict the use of any form of adjustable rate finance. Last year, testimony was offered before the full Senate Banking Committee, by both the Mortgage Bankers Association and the Task Force on Creative Finance for Manufactured Housing, proposing a federal preemption of all state laws that prohibit, restrict or impede the use of adjustable rate finance instruments. Federally chartered depository institutions currently benefit from such a preemption. However, a large percentage of FHA loans are made by mortgage bankers, finance companies, and state-chartered institutions. A federal preemption of restrictive state laws would permit all types of lenders to compete on an equal basis in the financial markets. This competition would ultimately benefit homebuyers. We believe that without such a preemption, the adjustable rate mortgage insurance authority will be of use only in a limited portion of the country and will not have the positive impact on credit availability that is intended.

OTHER HOUSING PRODUCTION INITIATIVES

The Congress, and particularly this committee, have before them a number of housing stimulus proposals aimed at reviving the deeply depressed housing industry and retaining both jobs and home ownership opportunities for Americans. In general, let me say that we strongly urge that any housing production program which may be enacted, either an amended 235(q) program or programs as envisioned by S2226 or S.2327, or through a mortgage revenue bond subsidy, include manufactured housing, both single-and multi-sectional, and financed with or without land. We note with pleasure that S.2226 contains a number of provisions which are consistent with these recommendations.

The inclusion of manufactured housing in any legislated housing production program, particularly when manufactured homes both with and without land are eligible, provides substantial job stimulation and affordable home ownership opportunity. Single-section and multi-section manufactured homes sold without land are an effective means of providing home ownership. This is true both for families unable to afford land ownership in, for example, high land cost areas and traditional park settings, and for those who may already own land, particularly in rural areas.

While financing of manufactured homes as real estate is a recent trend, the predominant share of manufactured housing is financed as personal property through installment credit sale contracts with a security lien taken on the home, independent of the land to which it may be affixed. Any legislative housing program which is limited to real property mortgage loans effectively excludes most manufactured homes.

Likewise, for reasons such as affordability, land scarcity and energy usage, the vast majority of manufactured homes purchasesd as single- as opposed to multi-section homes. For example, last year single-section homes outsold multi-section homes by a factor of more than three to one. Personal property single-Section manufactured homes also present a viable low-cost housing component of the stimulus programs for families of lower income who might otherwise be precluded from participating.

The manufactured housing industry is beginning to suffer from the same economic difficulties of recession and high interest rates as the site-built housing industry, resulting in depressed production and elimination of jobs. For example, total manufactured home shipments for the most recent six-month period (August, 1981 through January, 1982) have declined approximately 6 percent from the same period of the prior year and 19 percent from the same period two years earlier. In fact, were it not for isolated demand in the energy-boom states of Texas and Oklahoma, the decline in shipments would be substantially more dramatic.

The inclusion of manufactured housing, both with and without land, in any federal housing production program will provide both substantial job stimulation and affordable home ownership opportunities.

For example, on a dollar-for-dollar basis, the employment multiplier is higher in the manufactured housing industry than in the site-built industry. On the average, manufactured homes without land are approximately 25 to 35 percent less costly than site-built homes with land. This means that for every site-built home that can be produced with a given number of dollars, three to four manufactured homes can be built. Thus, while an expenditure for site-built housing creates greater on-site construction employment, a similar amount spent on manufactured housing will create greater off-site job opportunities both in the manufactured housing factory itself and in ancillary services such as delivery, site preparation and set-up. Also, such expenditures generate greater quantities of appliances, fixtures, and furnishings. Using a sales price ratio of three or four to one, equal expenditures on manufactured housing will produce three to four times as many refrigerators, sets of furnishings, carpeting, drapes and other housing-related goods.

With regard to affordable housing opportunities, manufactured homes, in single- and multi-sections, sold with and without land, may be the only real option for many families. S. 2226 does not limit the percentage of manufactured homes that could be assisted under the interest rate write-down provisions. We strongly support this view. Such a restriction limits the ability of government to meet its responsibility to low-income families and to assist in providing decent, safe and affordable housing for Americans.

Assistance under the existing 235(q) statute provides for interest rate subsidies that would reduce the interest rate to 9½ percent (12 percent for manufactured homes). Your bill, Mr. Chairman, calls for a reduction of the interest rate to 11 percent, not to exceed a 4 percent reduction, whichever is less. Additionally, Section 235(q) calls for assistance over the life of the mortgages, while S. 2226 limits assistance to five years, with the subsidy declining beginning with year two.

We favor provisions such as those in S. 2226 which would reduce the period and the depth of the interest rate assistance in order to assist a greater number of households and finance a greater number of homes for the funds appropriated. This could be accomplished, at least with respect to manufactured housing, without any substantial increase in the income levels of those who could participate in the program, given the wide range of prices and product choices available in this affordable housing alternative.

MORTGAGE REVENUE BONDS

Finally, we note that there has been some growing interest on the part of the Administration and the Congress in reviving the tax-exempt mortgage revenue bond program. We would urge that the Congress consider manufactured housing if this program becomes a vehicle through which the Administration or Congress decides to provide stimulus to the housing industry. We understand that Congressmen Corcoran and Evans have introduced an amendment in the House of Representatives that would allow for additional assistance through the tax-exempt mortgage revenue bond program by reallocating funds previously appropriated for the synfuels program. Unfortunately, manufactured housing would not benefit from this proposed stimulus under existing Treasury regulations which limit manufactured housing participation to manufactured homes permanently affixed to real property. It is our feeling that it was not the legislative intent of Congress to preclude manufactured homes from participation in these programs.

Manufactured homes not permanently affixed to real property, whether home-only or home-and-land combinations, are precluded from participation under current regulations. We would urge the Congress to look into these restrictions and would be happy to assist this Subcommittee or others in identifying solutions.

CONCLUSION

In conclusion, I want to thank you, Mr. Chairman, and the entire Subcommittee for allowing me the opportunity to appear before you today on behalf of the Manufactured Housing Institute and the Coordinating Council on Manufactured Housing

Finance to testify on the Administration's proposals and other housing proposals before you. Again, the Manufactured Housing Institute and the Coordinating Council strongly recommends that the Congress include manufactured homes on a parity basis with other forms of housing in considering the reauthorization and expansion of FHA authority to meet the needs of Americans in acquiring safe, decent and affordable shelter.

We hope that you will give serious consideration to our suggestions. I would be pleased to answer any questions you might have, and our Washington counsel would be happy to work with the Subcommittee staff in perfecting any of the recommendations we have made today.

Senator LUGAR. Thank you very much, Mr. Smith.

Senator Proxmire, do you have questions?

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Smith, I'm delighted to hear you speak on behalf of manufactured housing. Our State, along with Georgia and Indiana and a few others feature manufactured housing and it's very important for our economy. Several of our big cities in the State are in very serious trouble because manufactured housing is in serious trouble. So I'm delighted that you spoke as you did.

Mr. Waldo, you stressed in your presentation the importance of reducing the deficit and strict control over spending and fiscal policy, and I couldn't agree with you more.

Do you think that any kind of bill we pass is going to do much good in the long run unless we get our fiscal policy under control and get the Federal Government out of the credit markets?

Mr. WALDO. As I said in my statement, Senator, with interest rates at 16 percent, only 10 percent of the borrowers can afford to buy homes, and that's just not acceptable, and I don't think that that's going to improve until real interest rates come down.

Senator PROXMIRE. What will bring them down?

Mr. WALDO. Just less demand for credit and we perceive the Federal Government's demand is crowding everybody else out of the market.

Senator PROXMIRE. Well, that certainly is my concern. I have great admiration for the chairman of this committee and I think he has introduced a bill which I think can be helpful. I'm concerned however. I wrote to the Chairman of the Federal Reserve Board and asked him if he would accommodate this bill. As I calculate it, it would mean $26 billion of additional credit and I'm concerned that the additional credit would come, to some extent, at the expense of other housing that might otherwise have been financed, and to some extent at the expense of other credit activity that would otherwise proceed.

NEED FOR EMERGENCY ASSISTANCE

Others deny that and say there's a window here and that in any event that the homebuilding industry is in such dire shape that they do need some kind of emergency assistance, even though there may be a further adverse impact of even this kind of Federal activity because, after all, this does involve a Federal initiative which would absorb additional credit.

What's your feeling about that?

Mr. WALDO. Well, I think, Senator, that housing is in dire straits right now and some stimulus does have to be provided. It would seem to me that any kind of stimulus that is provided now, though, there should be some provision made for repayment of that at some future point.

Senator **Proxmire**. Well, the Lugar bill provides exactly that as far as a payback.

Mr. **Waldo**. Yes. That's correct, because while that does further burden Federal credit right now, at least it provides some hope for most of it being repaid in the future. I think that is important.

Senator **Proxmire**. So with this provision, would you feel that this would be a constructive initiative and would in the long run benefit housing in spite of the fact that it would obviously come into a market which is already credit starved and absorb additional credit?

Mr. **Waldo**. I think it would, Senator, yes.

Senator **Proxmire**. I got the impression from you, Mr. Waldo, that you said—maybe I misunderstood what you said—that there should not be a need for Federal insurance of mortgages? Is that wrong or right?

Mr. **Waldo**. In the unsubsidized market, that's correct, Senator.

Senator **Proxmire**. Wouldn't that result in a risk premium that would push interest rates a little higher on mortgages even than they are now? And now, I saw the other day, 17.5 percent average, which is absolutely unconscionable. If you deprive any part of the mortgage market of the insurance that they're now getting, why wouldn't that result in a still higher interest rate?

Mr. **Waldo**. Senator, the conventional mortgage-backed securities that have been sold in a totally illiquid market—we've put out about 3 billion of these in the last couple years—are trading right now for about 1 percent over the GNMA rate. Actually the FHLMC PC's are trading for about 10 to 30 basis points over GNMA's and FNMA's brand new program is trading at 50 or 60 basis points over GNMA's. So there isn't really that much of a spread between the GNMA's and the conventional mortgage-backed securities right now, and given a better market, given a much broader market in conventional securities, I think that spread would be narrowed even more.

Senator **Proxmire**. What concerns me, Mr. Waldo, in the first place, I'm very proud of the fact that your company was a fine company in Madison, Max Karl's company in Milwaukee is a great company, and I think you've done a super job in this area and it's good to have the private sector move in when they can.

But I understand that during the depression, mortgage insurance companies had great difficulty with many of them going under. And shouldn't we become concerned that with economic conditions as they are today that private insurance companies will once again find themselves having trouble staying afloat?

Mr. **Waldo**. In 1972, the Arthur D. Little Co. did a study for FNMA and for FHLMC and I think the FHA also participated in funding it. They examined very thoroughly the whole private mortgage insurance industry and concluded that given the reserve structure of this industry and the differences between this industry and the industry of the 1930's, that this industry today could get through another situation like the 1930's.

What happened to the previous industry, Senator, was that they indiscriminately insured any kind of loan that came in the front door, whether it was a construction loan, land loan, commercial loan, residential loan. The mortgages were not amortized. They provided for no reserves. And so, consequently, when the time came for them to pay claims, they just didn't have the funds to do it.

Senator **Proxmire**. Mr. Waldo, that study was done in 1972. Wasn't 1972 an extraordinarily good year?

Mr. **Waldo**. Actually 1972 was about the time that our industry really started taking off. Most of our business has been done since 1972.

Senator **Proxmire**. I wonder if a study today would be as reassuring.

Mr. **Waldo**. Arthur D. Little just recently did sort of an update, and I think that is available. We would be glad to make copies of that available to the committee.

Senator **Proxmire**. I'd appreciate that very much.

[Copy of the study referred to follows:]

MORTGAGE INSURANCE COMPANIES OF AMERICA
1725 K STREET, N.W., SUITE 1405 — WASHINGTON, D.C. 20006 — (202) 785-0787

JOHN C. WILLIAMSON
EXECUTIVE VICE PRESIDENT

STEVEN P. DOEHLER
STAFF VICE PRESIDENT

April 30, 1982

The Honorable William Proxmire
5241 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Proxmire:

On April 14, 1982, when Robert L. Waldo, President of Verex Assurance, Inc. of Madison, Wisconsin, testified before the Senate Housing Subcommittee in his capacity as President of Mortgage Insurance Companies of America (MICA) you questioned him concerning the financial solidity of the present mortgage insurance industry. The conclusion in the 1975 Arthur D. Little, Inc. (ADL) report that the mortgage insurance industry could withstand another Great Depression in a worst case scenario was discussed. At that time you requested any updates on Arthur D. Little's conclusions about the financial solidity of the industry.

Two conditions contributed to undermining the financial soundness of the private mortgage insurance industry prior to the 1930s. First, the operation of the industry involved conflicts of interests due to the lack of an "arm's length" relationship between lenders and mortgage insurers which primarily contributed to the collapse of the industry. Second, the lack of adequate reserves to meet the demands on the industry in times of extreme economic dislocation was another contributing factor in the collapse of the industry in the 1930s. With the reincarnation of the private mortgage insurance industry in the 1950s both of these conditions were changed to insure the financial solidity of the new private mortgage insurance industry. Lenders are no longer allowed to own mortgage insurers to insure their loans, and the contingency reserve was established, in addition to other reserves required for mortgage insurers, specifically to meet the demands on an insurer of a severe economic downturn.

In response to your request for updated information, enclosed is the 1981 ADL study, *Establishing Reserves In Mortgage Guaranty Insurance*, which MICA requests be inserted in the hearing record. Undertaken at the request of MICA, this study discusses the contingency reserve established to meet the special risk in mortgage insurance of insuring against catastrophic loss. ADL concludes that the contingency reserves of the industry are adequate to maintain a financially sound industry even in times of economic dislocation.

If MICA can offer additional information concerning this industry please do not hesitate to contact us.

Sincerely,

John C. Williamson

JCW/mbg
Enclosure

ESTABLISHING RESERVES IN MORTGAGE GUARANTY INSURANCE

EXECUTIVE SUMMARY

Reserves are one of the few elements common to all types of insurance. They reflect a major economic characteristic of the business: namely, that insurers receive premium payments today for claims and other obligations which may become payable in the future. Reserves are the accounting reflection of potential liabilities and contingencies generated by underwriting.

The unearned premium reserve is equivalent to the portion of premium paid in advance on a policy which may be returned to the policyholder in the event of a cancellation or, if the insurer defaults, may be needed to purchase reinsurance. Loss and loss expense reserves for property-casualty products provide for potential claims under the policy. Asset valuation reserves are established to protect against fluctuations in asset values.

RESERVING PHILOSOPHY

Actuaries, accountants, and economists have different philosophies regarding insurance reserves. The actuary takes a very conservative view, establishing reserves as if the insurer had to liquidate and settle all obligations continuously. Statutory insurance accounting principles embody the actuary's philosophy by generally deferring recognition of income and accelerating recognition of expenses. Thus, the actuary requires that reserves be established to provide for any contingency, using conservative and, in some instances, pessimistic assumptions about future developments.

The accountant's view is formalized in generally accepted accounting principles (GAAP) and mandates the matching of revenue and expenses on the basis of events which are known or likely to happen. For some insurance products, ultimate losses may not be known for many years and/or may be based upon rare but catastrophic events. Thus, the reserve levels established under GAAP sometimes result in overstating current revenue.

The economist views the insurance entity as fulfilling a risk transfer function that is necessary to the economy. Thus, the insurer's solvency, (i.e., ability to satisfy obligations) and solidity (i.e., ability to provide continuity of the risk transfer service) are of paramount importance. To the economist, reserves reflect a key portion of the capital necessary to assure the insurer's solidity and solvency.

Mortgage guaranty insurance protects the lender or investor in a mortgage against default on the part of the borrower. Individual products are sold with coverages ranging from 10% to 30% of the claim amount (outstanding loan balance, accrued interest, and expenses), while policies for mortgage pools can provide coverage of up to 100%. Mortgage guaranty insurance has unique characteristics that dictate the need for a special reserve: the mortgage insurance contingency reserve.

Prepared For The

MORTGAGE INSURANCE COMPANIES OF AMERICA

July 1981

Mortgage guaranty insurance poses unusual risks: the industry was devastated by widespread defaults in the 1930's. State insurance regulators accordingly established special requirements for the contingency reserve when the industry again began operations in the late 1950's. However, the existence of state laws defining the calculation of the reserve is not unusual; similar regulations concerning calculation procedures and reserve levels are common, for all types of insurance products.

NEED FOR THE CONTINGENCY RESERVE

Specific policy structure and loss characteristics distinguish mortgage guaranty insurance from other insurance products. This insurance is guaranteed renewable at rates stated at the inception of the policy. The lender can, and often does, cancel the coverage after the outstanding loan balance reaches a specified percentage of the property value or after a period of favorable payment history. As a result of this adverse selection process, higher-risk loans remain in the insured portfolio as it ages.

Mortgage insurance losses can be placed into three categories:

- Normal losses associated with regular business cycles, interruptions in the borrower's earning power, and random errors made in underwriting;
- Localized, widespread default caused by adverse local economic conditions; and
- National, widespread default caused by a severe depression.

The first category translated into an expected average mortgage default rate of 1-2% during the 1960's and 1970's. During the 1930's, the default rates were 12-14%. Since 1957 the Federal Housing Administration has experienced depression-level mortgage defaults in some areas of the United States due to localized economic conditions and an average default rate of 6% for 30-year mortgages initiated under the Title 203 program.

The mortgage insurance contingency reserve provides for protection against all three categories of loss. In most states, the contingency reserve can be used to pay claims when the incurred losses exceed 35% of earned premium. Depending upon the policy coverage, this could occur at a mortgage default (claim) frequency as low as 2%, if insurers are unable to mitigate their losses through property acquisitions or negotiated settlements.

THE CONTINGENCY RESERVE AND RISK

In most states, the contingency reserve is specified as 50% of earned premium; in Wisconsin, it is specified as either the former or 0.125% of the outstanding loan balance, whichever is greater. The earned-premium basis fails to relate the contingency reserve to risk unless the premium adequately reflects risk. Wisconsin's alternative method relates the contingency reserve directly to potential liability.

Various new mortgage instruments that have emerged in recent years pose different risk elements than do the standard fixed-payment mortgage common since World War II. Mortgage insurance premium rates are still applied to the outstanding mortgage balance, but this does not explicitly reflect all of the risk elements associated with these new instruments. Thus, during the 1980's, the mortgage insurance contingency reserve may be required as a backstop for the "normal" losses arising from new mortgage instruments, to the extent that the risk elements translate into higher default rates.

Mortgage insurance products have been developed for mortgage pools. Depending upon the state, the pool policy can cover a portfolio of either low-downpayment loans (5-10% equity) or loans with at least 20% downpayment (or insured by another company down to that level). The new pool products often have a coverage equal to 100% of the loss in the event of a default, subject to an aggregate loss limit. The premium rates charged for these policies are expressed as a percentage of outstanding loan balance but are considerably lower than the rates charged on individual policies. This is partly because the pools often consist of mortgages with 20% or more equity, but price competition is also a factor.

In recognition of the lower premium charged for pool policies, Standard and Poors will not rate a mortgage-based security covered by mortgage insurance unless the insurer has a 7:1 ratio of liability to capital. This is considerably lower than the 25:1 ratio required by state insurance commissioners and apparently reflects the belief that lower premiums generate a lower contingency reserve and thus require higher levels of surplus to support mortgage pool policies.

RELATIONSHIP OF RESERVES TO SOLIDITY AND SOLVENCY

The solidity and solvency of an insurer are dependent upon the adequacy of premiums charged, the adequacy of reserves, investment practices, the level of capital, and other factors. Policy pricing and contingency reserve formulas that result in a cumulative contingency reserve over the policy life that is lower than the level of required surplus have adverse implications for industry solidity and profitability.

Today, individual mortgage insurance products still dominate the mortgage insurance business, and most mortgages are of the standard, fixed-payment type. Since the product pricing and contingency reserve formulas for this portion of the business are the same today as in the 1960's and 1970's, the premium levels and contingency reserve levels for this portion of the business are probably adequate to protect against all three categories of loss. However, the additional risk posed by new mortgage instruments is not yet totally reflected in either pricing or contingency reserve calculations. The mortgage insurance contingency reserve can provide for adverse mortgage default experience up to the levels experienced in the 1930's, but it remains to be seen whether the reserve will also be sufficient to absorb losses associated with the new mortgage products and mortgage pools.

I. INTRODUCTION

The basic nature of insurance is such that premiums usually are paid in advance of the insurance protection being rendered. Further, considerable time can elapse between the occurrence of a loss, filing of a claim, and claim settlement. Accordingly, insurers must establish reserves to provide for obligations arising from insurance policies. Insurance regulations provide guidance or explicit requirements used to determine reserve levels. These regulations emphasize insurer solidity and solvency to protect policyholders and are often embodied in statutory accounting principles. To help ensure solidity and solvency, reserves are generally established on a conservative basis.

Representative balance sheets for a life insurer, property-casualty insurer, and mortgage insurer are shown in Table 1. Reserves constitute the major liability items found on an insurance company's balance sheet. The financial structure of an insurer reflects the nature of the insurance mechanism. The principal components of the balance sheet are similar for all types of insurers, but the relative importance and distribution of assets and reserve accounts differ according to the lines of business in which the insurer participates.

TABLE 1

PRO FORMA BALANCE SHEETS OF INSURANCE COMPANIES

Assets	**Property-Casualty Company**	**Life Insurance Company**	**Mortgage Insurance Company**
Cash	2	1	1
Agents' Balances	8	NA	<1
Bonds	66	47	76
Common and Preferred Stock	17	9	20
Mortgages	<1	27	1
Real Estate	1	3	1
Other Assets	6	13[a]	2
Total Assets	100%	100%	100%
Liabilities & Surplus			
Policy & Loss Reserves	68	82	26
Mandatory Security Valuation Reserve	NA	6	–
Contingency Reserve	NA	NA	43
Other Liabilities	8	5	4
Total Liabilities	76	93	72
Capital & Surplus	24	7	28
Total Liabilities & Surplus	100%	100%	100%

a. Includes policy loans.

Sources: *Best Aggregates and Averages, 1979; Life Insurance Fact Book, 1979*

The types of investments insurers make are restricted to the items that are approved as assets (admitted assets) by insurance regulators. Generally, admitted assets are negotiable securities and other liquid assets that can be readily converted into cash to meet obligations to policyholders.

Policyholders' surplus is merely the difference between the statutory value of assets and liabilities (principally reserves). It can be thought of as the amount by which a company's assets can shrink in value and/or its losses can exceed reserves, and not impair the company's ability to meet fully its obligations to policyholders. The magnitude of reserves relative to policyholder's surplus differs by type of insurance company. Generally, the longer the time period between premium receipt and loss payments, the larger are the reserves relative to policyholder's surplus.

Statutory requirements for reserves levels were developed to provide some assurance that reserves will be adequate to meet policyholder obligations. The longer time lag between the establishment of a reserve and the ultimate claim payment, the greater the uncertainty surrounding the adequacy of a reserve to meet policyholder obligations. Thus, as this time frame lengthens, the basis for estimating and establishing reserve levels becomes more conservative.

This paper discusses various aspects of insurance reserves in general and the mortgage guarantee contingency reserve in particular.

- Chapter II, "The Function of Reserves in Insurance," includes a discussion of the different types of reserves established for insurance products; the relationship of reserves to premium and risk; and alternative reserving philosophies of the actuary, the accountant, and the economist.
- Chapter III, "The Need for Reserves in Mortgage Insurance," includes a description of statutory and regulatory reserve requirements in several lines of insurance and the need for the contingency reserve as it relates to the nature of the mortgage insurance product.
- Chapter IV, "The Relationship of the Contingency Reserve to the Insured Risk," identifies the various risk elements that must be covered by the contingency reserve and the differences in contingency reserves calculated from formulas based upon liability or upon premium.
- Chapter V, "The Relationship of Reserves to Solvency and Solidity," includes a discussion of the relationship between the contingency reserve and surplus and the implications for company solidity.

The general conclusion reached in this paper is that the mortgage insurance contingency reserve, while unique, is based upon the same, sound insurance practices utilized to establish reserves in other insurance products. The contingency reserve is multi-purpose, in the sense that it is a mechanism for dealing with the following features of mortgage insurance and the insured hazard:

- Major timing differences between premium receipts and loss payments;
- Fluctuations in normal claim frequency;
- Local, severe economic conditions resulting in higher than normal claims; and
- Widespread severe economic conditions resulting in catastrophic losses.

During the 1980's new demands will be placed on the contingency reserve related to the yet-unknown risks associated with products developed for new mortgage instruments and mortgage pools.

II. THE FUNCTION OF RESERVES IN INSURANCE

A. RESERVES AND INSURANCE PRODUCTS

Reserves are a major component of the capital used and needed to support an insurer's ability to assume risks. For many insurance products, the amount of reserves can exceed the amount of surplus.

Reserves are established to provide for potential liability and contingencies generated by underwriting. The reserve calculation generally is related to the source of potential liability; separate reserve accounts are established for different sources of potential liability.

The major categories or types of reserves are the following:

- Unearned premium reserves, which provide for the potential need to return premium to policyholders in the event of a cancellation or to purchase reinsurance for the balance of the policy;
- Loss and loss expense reserves, which provide for potential claims that must be paid under the policy; different reserves are established for claims with different degrees of certainty and knowledge.
- Asset valuation reserves, which provide for potential fluctuations in the value of assets.

1. Unearned Premium Reserve

In the early 19th century, a common practice in the insurance industry was to recognize premium as revenue fully at the time the policy was written. Since insurance policies generally are designed to be in force from one to many years, this was tantamount to recognizing revenue before the insurance service had been provided. Starting in 1848, the insurance companies operating in New York were required to establish a liability reserve sufficient to reinsure outstanding risk. This practice is now the general rule for all lines.

The unearned premium reserve is equal to the amount of premium written that has not yet been earned or the amount that would be refunded to policyholders if the policy were cancelled. Insurance statutes and regulations do not allow reducing the unearned premium reserve for prepaid expenses, which includes agents' commission, taxes, and other acquisition costs. Further, according to state insurance accounting requirements, these prepaid expenses cannot be shown as an asset on the balance sheet, although they can be shown as a prepaid expense asset under Generally Accepted Accounting Principles (GAAP).

Unearned premium reserves can be calculated on an aggregate basis based upon premiums in force or as the sum of the unearned premium on individual policies. For the aggregate calculation, premiums in force as of the valuation or statement date are summarized by month and year of expiration and multiplied by an unearned premium factor. The unearned premium reserve also can be calculated by applying a factor to individual policies.

Methods of developing unearned premium reserve factors for property/casualty lines are (1) the annual pro-rata method, which assumes policies are issued evenly throughout the policy effective year, and (2) the monthly pro-rata method, which assumes policies are issued evenly over the policy effective month.

Non-cancellable accident and health policies commonly have a level premium. Since medical examinations often are required as a condition of coverage, several years may elapse between the beginning of the policy and the onset of disability. Thus, premium is redundant (greater than needed to meet anticipated claims) for early years and inadequate for latter years. Insurers are required to establish an active life reserve against this future liability; this is called an "additional reserve" and is treated like the unearned premium reserve,[1] although it may be thought of as a future-loss reserve. The reserve is calculated for different age cohorts of policyholders, using morbidity and mortality tables.

Life insurers must establish policy reserves to provide for future benefits payable under life policies. Like non-cancellable accident and health policies, whole-life products charge a level premium over the contract period. Since mortality rates increase with age, the premiums paid by an individual who takes out a policy at age 30 will exceed the mortality risk in the early years and be less than the mortality risk in later years. The net level reserve is designed to consider the pattern of premiums and losses and is equal to the present value of future benefits minus the present value of future net premiums (i.e., premium receipts net of expenses and loadings). The calculation is based upon mortality tables and interest rates specified by statute.[2]

Some surety bonds are issued for an indefinite period for a single premium, and surety companies earn the premium over a term of seven years, approximately equal to the statute of limitations.[1] Other, special formulas may be developed for particular lines of insurance. Multi-year policies with installment premiums are often treated as a series of individual policies.

The method of calculating the unearned premium reserve for mortgage guaranty insurance is typical of that used for property-casualty products. Annual policies with loan-to-value ratios below 90% are earned pro-rata, and the unearned premium reserve is simply the unearned share of premium written. For annual insurance policies on mortgages with loan-to-value ratios above 90%, practices differ within the industry: some companies earn the portion of first-year premium in excess of twice the renewal premium is earned according to the schedule for a ten-year, single premium policy, and the balance pro-rata; others earn the entire premium over the first annual term. Single-premium policies are earned pro-rata or by other schedules over the period covered by the single premium. Unlike accident and health and life products, the unearned premium reserves mandated for mortgage guaranty insurance do not take into account the non-cancellable feature nor the delayed-loss pattern of this line.

2. Loss and Loss Expense Reserves

The calculation of underwriting profit or loss for an insurance company's accounting period requires that premium earned during the period be matched against the costs incurred during the period. Insurance accounting is on a cash basis for expenses paid and on an accrual basis for potential expenses that have been incurred and not paid. Thus, an insurer is required to deduct the full amount of commission and other acquisition cost against premium earned as well as both the loss and loss expense paid as of the statement date and potentially payable.

At the end of an accounting period, the ultimate value of losses and loss expense that will be paid under policies in force is unknown. Ultimate loss and loss expenses must be estimated and reserves established for the portion that has been incurred but not yet paid out in claims. For most property-casualty lines, the two major loss-reserve categories are:

- Case reserves for future payments on claims that have been reported and are currently outstanding, that are believed to require future payments, or that could be reopened.
- Incurred But Not Reported (IBNR) reserves or potential liability for claims arising out of events which are believed to have already occurred but are not yet known or reported to the insurer.

Property insurers may also establish catastrophe reserves against the potential liability arising from severe, highly erratic events that are not predictable (e.g., hail and wind storms). The mortgage guarantee contingency reserve is like a catastrophe reserve, in that it is designed in part to provide protection against catastrophic economic conditions.

Non-life companies use a variety of loss-reserving methods, several of which are surveyed in a seminal paper by David Shurnick.[3] Others have developed methods of evaluating loss reserves.[4-7] "No single reserving method can possibly produce the best estimates in all situations. Every reserving method is based on certain underlying assumptions which may or may not be satisfied in a given situation."[8] Thus, a method that is appropriate for one line of business may not be appropriate for another.

a. Case Reserves — Loss and Loss Expense

Reserving methods for case reserves for reported claims include the following:[3]

- Individual claim file estimates: The claims adjuster's best estimate on individual claims, which is revised periodically as long as the claim remains open.
- Fast-track reserves: The expected average claim value for a category is used for each claim reported; if claims remain outstanding beyond a given length of time, case reserves are substituted. This method is appropriate for certain property lines of insurance, such as auto collision.

- Tabular value reserve: For some property-casualty lines, such as Worker's Compensation, and accident and health products such as disability income, the claim amount estimate can be taken from a schedule or easily calculated from actuarial tables.
- Notice-average method: The fast-track method with a policy year trend in average value.
- Runoff method: The aggregate value of outstanding claims is adjusted on the basis of the cumulative incurred and paid losses, adjusted by calendar-year loss development factors.
- Correct case reserve for bias: Case reserves are adjusted to reflect bias in estimates for recently settled claims.
- Report-year loss development: Different loss development factors are calculated by year of reporting and used to estimate ultimate losses for each age category of claims.
- Projection method: Paid loss to date is adjusted by historical development factors (either report year or accident year).
- Payment development method: Reported-year incurred loss is estimated by estimating the ultimate average value of reported claims based upon historical development factors.
- Loss ratio method: An estimated loss ratio is applied to earned premium, and losses paid to date are then subtracted to calculate the reserve.[9]

All but the last method rely upon an analysis of losses reported and paid or loss development factors calculated using previous loss experience. The loss ratio method is not an independent estimate of reserves but is dependent upon premium earned. It is useful for a new line of insurance, where experience is not available, for undeveloped (very recent) policy years, and for other situations where adequate information is unavailable. It requires premium adequacy and correct estimates of ultimate loss ratios in order to provide adequate reserves.

Reserves are also established for loss expenses, which can be subdivided into allocated and unallocated components. Allocated loss expenses are those directly related to the adjusting and settling of individual cases, such as salvage costs, legal fees and costs of subrogation. Unallocated loss expenses include all the costs of claim administration and settlement that are not associated with particular claims.

For some liability lines, where fluctuations in the value of loss expense on individual cases tend to be related to the value of losses, it is appropriate to estimate the loss and loss expense reserve combined. Otherwise, loss expense reserves can be evaluated through development procedures in the same fashion as loss reserves.[10] For lines in which loss expenses are stable relative to losses, it may be practical to use an historical experience ratio of loss expense reserves relative to losses.

Mortgage guaranty insurers establish case reserves for delinquent insured loans and claims filed. The reserve for delinquencies is calculated by multiplying the outstanding loan balance by the policy coverage and a cure ratio reflecting historical experience. Case reserves are established for claims filed on the basis of the coverage ratio multiplied by the claim amount (which includes the outstanding loan balance, accrued interest, and certain other allowed expenses).[11]

When presented with a claim, mortgage guaranty insurers may elect to pay the claim in full and take title to the property. Since they will incur expenses while carrying the acquired properties and at the time of disposal, some establish an expense reserve or reduce the carrying value of the property at the time title is taken; others recognize these expenses when they dispose of the property. The reserve established is based upon historical experience.

b. Claims Incurred But Not Reported

Liabilities from potential claims arising out of events that have occurred but have not been reported can be estimated by a variety of methods:

- The runoff method relies on loss development and reporting factors for accident-year loss development.
- IBNR reserve factors can be taken as a percentage of a base, which can be outstanding reserves, total losses incurred to date, premium in force, or earned premium.
- IBNR trend factors can be developed from historical data and applied to the previous year's IBNR.

The Tarbell method, which relates IBNR to incurred losses, was developed in 1934 and is an example of the second method.[12] For fidelity and surety coverages in New York, IBNR reserves must be equal to at least 10% and 5% respectively of premiums in force.[13]

For mortgage guaranty insurance, IBNR is a reserve for delinquencies that have occurred but have not been reported to the insurer. The method of calculation varies by company: some utilize a factor multiplied by known delinquencies, some use a percentage of premium, and a few have established a fixed sum as the IBNR reserve value.[14]

3. Catastrophe Reserves

Property-casualty companies establish catastrophe reserves as a segregation of surplus. For lines of business susceptible to infrequent but unusually large losses, sound ratemaking practice requires that they be included in the premium calculation. However, an averaging process is used whereby actual catastrophe losses are removed from annual losses in the experience base and the annual average or expected value of those losses is substituted. These calculations are "based upon a long range view of at least twenty years" in the case of homeowners' insurance.[15]

Other actuaries recommend that catastrophe reserves be established through the use of a deferred revenue account for "unused, non-reinsured catastrophe premiums."[16] The calculated portions of net premium would flow into the deferred revenue account, be excluded from earned-premium calculations, be held subject to a maximum accumulation, and released into revenue when the catastrophe takes place. The experience period utilized for the calculation should be ten or twenty years.[16]

Accident and health insurers may establish a contingency reserve if they lack a statistically credible block of experience in a specific policy form and, if warranted, to provide for the influence of outside factors such as economic conditions.[17]

4. Mortgage Insurance Contingency Reserve

a. Private Mortgage Insurance

A contingency reserve is established by mortgage insurers as a charge against income (Wisconsin) or an adjustment to surplus (other states). The purpose of the reserve is to provide funds for losses that can arise from severe economic conditions. In all states it is shown as a liability on the balance sheet.

The mortgage insurance industry in the United States had its origins in the late 19th century. However, the industry became insolvent and virtually disappeared in the depression of the 1930's. The Federal government was the principal insurer of mortgages from 1934 to 1957. When the private mortgage insurance industry was revived in Wisconsin, insurance statutes required the establishment of a contingency reserve to forestall a collapse of the industry from severe economic conditions such as those of the 1930's. The contingency reserve serves a dual function regarded as essential by the regulators: it encourages the establishment of adequate premiums and provides some assurance that funds are not dissipated but are available to cover fluctuations in normal losses as well as catastrophic losses.

The contingency reserve for most mortgage guaranty products is calculated as 50% of earned premium.* Contributions to the contingency reserve remain in the reserve for 120 months in most states, but they may be released earlier if the underwriting loss ratio exceeds a specified level (e.g., 20% or 35%). When contributions to the contingency reserve are released in Wisconsin, they flow into income; in other states, they move from a liability account to unassigned surplus. Regardless of whether the reserve is deducted from income on a statutory basis, when calculating its tax liability the mortgage insurer may deduct from income net additions to a special tax account known as the "mortgage guaranty account." However, the Internal Revenue Service requires that the deferred tax liability created by this deduction be placed in non-interest-bearing tax and loss bonds.

Mortgage guaranty premiums are generally expressed as a percentage of the outstanding loan balance. Policy coverage is expressed as a percentage of the claim value (the outstanding loan balance plus expenses). Thus, while the reserve is calculated on the basis of premium, for individual products, the reserve was intended to be related to potential liability. If premium rates decline, however, contingency reserves established as a function of earned premiums will also decline in relation to the potential liability. This may undermine both of the goals of the contingency reserve. To guard against this possibility and still leave room for competition with respect to rates, the Wisconsin Insurance Department requires that additions to the contingency reserve equal the greater of 50% of earned premium or .125% of the outstanding loan balance. The underlying goal in tying the reserve to the liability or loan balance is to ensure a reserve adequate for the *risk assumed* by the insurer independent of the *price charged* for that risk.

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* Minimum levels of the contribution to the contingency reserve are required in Wisconsin for all products since 1975 and in Illinois (for pool products) since 1979.

The proliferation of new types of mortgages and new policy forms increases the importance of establishing a liability basis for the reserve calculation to protect the integrity and functions of the contingency reserve. New mortgage guaranty products developed for mortgage pools have deeper coverage, but they may not be insuring the first layer on high loan-to-value ratio loans because of statutory or regulatory restrictions (see Section III-A) or other reasons. Pricing on these policies is very competitive, and the premium charged is lower in relation to total liability than for individual products designed for one- to four-family homes. In recognition of this effect, one state (Illinois) has changed the basis of the contingency reserve calculation so that it is related to outstanding liability; other, more sophisticated changes are being considered in Wisconsin (see Section III-A).

b. FHA Mortgage Insurance Reserves

Under the authority of the National Housing Act of 1934 as amended, the Federal Housing Administration (FHA) operates various loan and mortgage insurance programs. The FHA mortgage insurance programs are extensive. They cover a broad range of high-ratio loan categories, including those for:

- Cooperatives, condominiums, 1-4 family housing, and mobile home units;
- Multifamily housing for various types of products (i.e., urban renewal projects, low- and moderate-income housing projects, housing for the elderly, nursing homes and/or intermediate care facilities, non-profit hospitals, and experimental housing projects);
- Victims of major natural disasters, civilian employees in armed services housing, low- and middle-income individuals, and special credit risk individuals.

Each of these individual types of insurance programs is authorized under its own Section or Subsection of the National Housing Act. The income and expense associated with them is channelled through one of four funds:

- The Mutual Mortgage Insurance Fund,
- The General Insurance Fund,
- The Cooperative Management Housing Fund, or
- Special Risk Insurance Fund.

The Mutual Mortgage Insurance Fund (MMIF) is the insurance reserve established for FHA Section 203(b). This and Sections 234, 244, and 245 are the sections of the FHA program which are directly comparable to the market served by private mortgage insurers. The MMIF provides primarily for the insurance of mortgages on new and existing one- to four-family dwellings, but it also provides for the insurance of mortgages on single-family dwellings to replace or repair homes damaged in major disasters and for the insurance of property improvement loans.

The insurance reserve for the Mutual Mortgage Insurance Fund stood at $1.6 billion as of the end of fiscal year 1980 while total appropriations and reserves on that fund's balance sheet amounted to $2.5 billion (Table 2). The outstanding loan balance on insurance in force under the Section 203 program was $61 billion. Thus, the risk-to-"capital" ratio at the end of fiscal year 1980 was about 24 to 1, or just below the requirement for private mortgage insurers.

5. Asset Valuation Reserve

This last category of reserves differs from the others discussed thus far, in that it is not an estimate of potential liabilities but, rather, an estimate of the potential decline in value of the insurer's investment portfolio that might occur as a consequence of severe economic conditions.

In most businesses, asset valuation reserves would be shown as a reduction in the value of assets on the balance sheet. For life insurers the mandatory securities valuation reserve (MSVR) is a liability reserve. Its calculation is based upon the statement value of bonds (0.1% per year with a 2% maximum) and the statement (market) value of stock (1% per year with a 20% maximum for shares in subsidiaries and 33% for all other stock).[18] The 2% cap on bonds is based upon long-term default rates in corporate bonds over a period that included the depression that occurred during the 1930's.

While the MSVR currently is required only for life insurance companies, the National Association of Insurance Commissioners (NAIC) has considered requiring this reserve for property-casualty insurers as a segregation of surplus. The sharp drop in the stock market along with a severe underwriting downturn in 1974-75 caused the surplus of property-casualty companies to fall precipitously. Some members of the NAIC argued that this would not have occurred if the companies had had an MSVR and a study subcommittee recommended adopting the MSVR. Separate studies of the issue were undertaken by the American Insurance Association and the NAIC.[19,20] After extensive study and discussion, the NAIC decided not to require an MSVR for property-casualty insurers.

B. THE RELATIONSHIP OF RESERVES TO PREMIUM AND RISK

As the preceding section demonstrates, reserves should be and generally are directly related to the potential liability for which they are designed (Table 3):

- The unearned premium reserve is directly related to the risk (potential return of premium), and premium is accordingly the calculation base;

TABLE 2

COMPARISON OF VALUE OF RESERVES TO SIZE OF PORTFOLIO FOR FHA MUTUAL MORTGAGE INSURANCE FUND

(in millions of dollars)

	FY 1980		FY 1979		FY 1978	
	March 31	**Sept. 30**	**March 31**	**Sept. 30**	**March 31**	**Sept. 30**
Total Insurance in Force						
Face Amount	72,815	75,140	67,355	69,501	64,110	65,199
Estimated Outstanding Balance (1)	61,011	63,192	55,855	57,878	52,794	53,818
Insurance Reserve						
Balance at end of Period (2)	1,595.5	1,553.9	1,550.4	1,499.1	1,451.6	1,449.1
Total Appropriations and Reserves at end of period[a] (3)	2,517.5	2,592.8	2,320.9	2,398.6	2,169.9	2,244.7
Ratio of Estimated Outstanding Balance						
To Insurance Reserve (1) ÷ (2)	38.24	48.36	43.44	47.96	44.17	44.99
To Total Appropriations (1) ÷ (3)	24.2	24.4	29.0	28.98	29.55	25.09

a. Total appropriations and reserves at end of period include total appropriated capital, participating reserve account for statutory reserves, and the insurance reserve.

Sources: Financial Statements, Department of Housing and Urban Development, Office of Finance and Accounting. *Summary of Mortgage Insurance Operations and Contract Authority*, Department of Housing and Urban Development, Office of Finance and Accounting, Financial Analysis and Investment Division.

TABLE 3

RELATIONSHIP OF RESERVES TO RISK

Reserve Type	Calculation Base	Experience Period	Potential Liability	Relationship To Risk	Relationship To Premium
Unearned Premium	Premium	Policy Period	Return of Premium	Direct	Direct
Net Premium					
Active Life Reserves	Morbidity & Benefits	Decades	Future Losses	Direct	Allocation of Premium
Loss & Loss Expense					
Case Reserve	Reported Claims	5 years	Normal Claim Payments	Direct	Unrelated
IBNR	IBNR Trends, Case Reserves Premium in Force	5 years[a]	Normal Claim Payments	Direct/Indirect	Unrelated or Directly Related
Catastrophy	Catastrophy Losses	10-30 years	Severe Loss Conditions	Direct	Unrelated
Contingency	Premium Earned[b]	50 years	Severe Economic Conditions	Indirect[b]	Direct
MSVR	Financial Assets	50 years	Severe Economic Conditions	Direct	Unrelated

a. Varies by line of business.

b. Statutory requirements for pool products in Illinois and individual products in Wisconsin, which stipulate minimum levels based upon outstanding loan balances.

- Active life reserves are allocated from premium but are calculated on the basis of factors related to risk (morbidity tables and benefit levels), independently of premium levels;
- Loss and loss expense case reserves for reported, outstanding claims are based upon claims reported, adjusted for potential loss development based upon historic claim experience and thus directly related to risk;
- IBNR reserves may be based upon trends in IBNR, case reserves, or premium in force — the former bases are directly related to risk (losses) and independent of premium, while the third calculation base is directly related to premium and only indirectly related to risk;
- Catastrophe reserves are based upon historic experience in catastrophic events over a long period (10-30 years) and thus are related directly to risk;
- The mortgage insurance contingency reserve, with some exceptions, is only indirectly related to risk, in the sense that the premium is a percentage of the outstanding loan balance; and
- The MSVR calculation is directly related to the assets that present the valuation risk, though there is some question as to whether the calculation method captures that risk.[21]

Another notable feature of the various reserves is the experience period on which the reserve calculation is based. The unearned premium reserve covers a potential risk that endures for the policy term. The net premium and active life reserves are established to cover exposure that could be several decades in the future; thus, the experience data upon which the calculation is based (morbidity and mortality tables) reflect many decades of experience.

For property-casualty products, case reserves and IBNR are based upon five or more years of experience data, depending upon the line of business and the length of the tail on the development curve. Catastrophe reserves are based upon 10-20 years of data or the experience cycle of the catastrophic event.

The MSVR reserve utilizes factors based upon more than 50 years of experience in stock and bond markets. The mortgage guarantee contingency reserve, like the MSVR, is designed to provide for severe economic conditions, or an economic cycle of 50 or more years.

C. ALTERNATIVE RESERVING PHILOSOPHIES

1. The Actuary

The actuary's philosophy toward reserves is embodied in statutory insurance accounting and actuarial reserving procedures. Conservatism underlies all reserve calculations and procedures established by the actuary. Income recognition is deferred, and losses are recognized as incurred. To the maximum extent, reserves are calculated objectively on the basis of statistically credible experience related to the level of loss exposure, not to the rate charged for the insurance.

Statutory accounting principals (SAP) are based upon liquidation values rather than the insurance company's position as a going concern. Thus, the actuary attempts to establish reserves that are sufficient to liquidate known and potential liabilities. The purpose in establishing a reserve is to provide some assurance that adequate funds will be available to cover these potential liabilities. Further, premium should be adequate to deal with expected contingencies related to underwriting and to provide an underwriting profit sufficient to maintain capital.

Establishing reserves is far from a precise science. For some lines of business, the actuary and claims adjuster can develop consistent and accurate estimates; in many other lines, however, losses vary substantially from year to year. If the loss variability cycle is extended, traditional actuarial techniques may not be adequate to develop estimates of reserve levels. Thus, reserving is still regarded as a mixture of art and science by actuaries.[20]

2. The Accountant

The philosophy of the accounting profession has been synthesized in Generally Accepted Accounting Principles (GAAP) and in the opinions of the Financial Accounting Standards Board (FASB) and its predecessor's opinions. The insurance industry's statutory accounting philosophy evolved through the application of actuarial principles and with full recognition of the insurer's fiduciary responsibility to its policyholders. Insurance accounting has been a stepchild of the accounting profession; the American Institute of Certified Public Accountants (AICPA) did not develop guidelines for fire and casualty companies and stock life companies until the late 1960's and 1970's.[22,23] The insurance industry "Audit Guides" provide instructions for auditing statutory accounts as well as for transforming insurance company financial statements from a statutory basis to a GAAP basis.

The accountant's GAAP view of the world is predicated largely upon experience with other (non-insurance) industries. The GAAP adjustments to reserves are of the utmost importance to an insurer, however. These adjustments are based upon concepts developed in other industries related to the proper matching of revenues and expenses. Thus, under GAAP the statutory values of earnings, equity and assets are increased to reflect the prepayment of acquisition expenses. In addition, loss reserves are allowed only for losses that occurred with reasonable certainty over the exposure period covered by the policy, on the assumption that this reflects costs related to premium revenue.

Chapter 6 ("Contingency Reserves") of Accounting Research Bulletin No. 43 stated the opinion that reserves should not affect income if created for such reasons as the following:[24]

> "(a) general undetermined contingencies, or . .
>
> (d) without regard to any specific loss reasonably related to the operations of the current period, or
>
> (e) in amounts not determined on the basis of any reasonable estimates of costs or losses."

If a reserve like this is established:

> "(a) it should be created by a segregation or appropriation of earned surplus,
>
> 32 (b) no costs or losses should be charged to it, and no part of it should be transferred to income or in any way used to affect the determination of net income for any year,
>
> (c) it should be restored to earned surplus directly when such a reserve or any part thereof is no longer considered necessary, and
>
> (d) it should preferably be classified on the balance sheet as part of shareholders' equity."

These requirements also apply to contingency reserves established in previous years.

In FASB 5, the estimated loss from a contingency can be charged to income under the following conditions:

> (a) Information indicates that "it is probable that an asset has been impaired or a liability had been incurred at the date of the financial statements . . . [i]t must be probable that one or more future events will occur confirming the fact of loss.
>
> "(b) The amount of the loss can be reasonably estimated."[25]

"Probable" is further specified to mean that "the future event or events are likely to occur."[26]

FASB 5 gives special attention to catastrophe losses of property-casualty insurance companies by defining the contingency associated with an insurance policy as the "risk of loss *assumed* by the insurance company, that is, the risk of loss from catastrophies that may occur *during the term of the policy*." Whether the insurer establishes a loss reserve for catastrophies or defers "any portion of the premium income *beyond the terms of the policies in force*," the reserve is not considered to be a legitimate charge against current income.[27]

Thus, the accountant's view appears to call for establishing liability reserves on [illegible] losses that can be estimated to *have occurred* with some degree of certainty. Other contingencies should not be charged against income; they should be a segregation of surplus. The accountant requires disclosure of potential tax liabilities associated with such allocations. While footnotes to a GAAP financial statement may disclose the amount established for the contingency reserve (which, of course, is reported as a part of the net worth or equity), GAAP does not require that such reserves be identified as a potential liability, unlike the requirements relating to pending lawsuits or long-term lease agreements.

The GAAP treatment of loss reserves for the insurance company is analogous to the treatment of costs for the widget manufacturer. The latter can deduct the labor, materials, and overhead costs associated with the widgets against income, but he cannot deduct a reserve for potential costs of lawsuits for widget product liability.

The accountants' treatment of, and position on, reserves evolved from their response to the accusation that they allowed the management of industrial corporations to "manage" earnings by establishing and drawing down all sorts of "contingency" reserves. In good years, a reserve would be established and charged against income; in poor years, charges against the reserve would raise the level of reported earnings. (These problems were mainly encountered in manufacturing and marketing companies and were not considered a significant influence on the earnings of insurance companies.) Accordingly, the AICPA determined that, inasmuch as management was abusing the concept, no contingency reserves would be allowed with respect to GAAP financial statements.

The accounting profession recognized that this presented problems for financial intermediaries — especially for insurance companies, whose very business it is to assume future risks, some classes of which have significant catastrophic components. Nevertheless, to further the concept of *Generally* Accepted Accounting Principles, contingency reserves were not allowed to be a part of GAAP for insurance accounting either. This has had a perverse result: whereas the disallowance of contingency reserves improved the accuracy of reporting income for most corporations, it has distorted the reporting of income of insurance corporations. Financial analysts, who regularly use accounting statements, generally adjust for these discrepancies when reviewing insurance company financial data.

3. The Economist

The economist's view is broader than that of the actuary or the accountant, for he is primarily concerned with the utilization of capital within the economy for the production of goods and services to satisfy society's requirements. The economist views insurance companies as fulfilling a very special and necessary role in the economy. By allowing investors to transfer risk and uncertainty from their investments to an insurance company, the insurance mechanism facilitates economic activity. However, if the insured is uncertain about the insurance company's ability to pay claims when due, or if the availability of insurance service is limited, the insurance mechanism cannot perform its proper economic function and general welfare is thereby diminished.

To the economist, insurance reserves reflect a key portion of the capital necessary to enable an insurance company to offer the prospect of successfully accepting the risks and uncertainties transferred by policyholders to it. Inadequate reserves diminish the effectiveness with which the insurer can be viewed as relieving the insured of the risk of loss. To the economist, an insurance company cannot function properly unless its reserves are adequate not only to deal with day-to-day fluctuations in loss experience but, where a catastrophic risk element is present, to offer reasonable promise of meeting losses under those catastrophic conditions.

In addition to functioning as the key element that supports the economic service of an insurance company (risk transfer), reserves together with surplus constitute the capital employed by the insurance undertaking. As such, the economist is concerned that this capital earn a rate of return commensurate with the business and financial risk to which it is exposed. The calculation of the net income earned or the capital employed is affected by the establishment of reserves of all kinds. The levels of reserves affect the size of the capital base necessary for conducting insurance operations. Since contributions to reserves for future liabilities are properly regarded as charges against income, they reduce the company's net income and rate of return.

Economic theory teaches[28] that firms and industries must earn a proper return on the total capital employed in their business undertakings. For an insurance company, the total return is composed of underwriting profit, calculated after accounting for all contributions to reserves, plus all sources of investment earnings including realized and unrealized capital gains. This figure is divided by total capital employed, primarily the sum of policyholders' surplus plus all reserves.

III. THE NEED FOR RESERVES IN MORTGAGE INSURANCE

A. STATUTORY AND REGULATORY RESERVE REQUIREMENTS

Not only must insurance companies establish the various types of reserves enumerated in Section II, but in so doing they must adhere to minimum standards covering both reserving assumptions and methods; in some cases, the levels of reserves are specified by statute or rule. In addition to mortgage guaranty insurance, minimum reserves are required by statute or regulations for life insurance and for certain liability insurance products.

1. Life Insurance Products

The NAIC developed a Standard Valuation Law for life insurance products which was used as a model by individual states. The state laws specify particular mortality tables — for example, the Commissioners' 1958 Standard Ordinary Mortality Table (1958 CSO) — as well as the maximum interest rate which can be used for policy life reserves. Most states that specify a minimum valuation basis use the Commissioners' Reserve Valuation Method. This statutory reserve calculation does not allow adjustments for voluntary policy terminations, such as lapses. Further, to provide a conservative estimate of the reserve, the allowed interest rate (4% in the 1972 NAIC amendments to the Standard Valuation Law) is below current levels.

When life insurers' reserves are changed from SAP to GAAP, the statutory life reserves are adjusted to reflect realistically expected mortality, interest rates, and voluntary terminations. Both the statutory requirements and GAAP adjustments are established with consideration of the underlying insured risk, although the former take a more conservative view of that risk.

2. Liability Insurance Products

Liability insurance products are characterized by long periods of time between the policy exposure period and the loss payment period. For any year early in the policy term, most incurred loss will be in the form of contributions to reserves for outstanding claims. The substantial increase in reserves on outstanding claims experienced by casualty companies in the mid-1970's, along with the wide fluctuations in losses for casualty lines during the 1970's, led the NAIC to establish minimum reserve ratios. For policies issued in recent years, the minimum loss reserve levels are equal to the lesser of (a) the specified loss ratio or (b) the highest loss ratio experienced for policies issued over the previous seven years.[29]

The minimum reserve levels for liability lines are based upon historic experience and thus are not designed to consider the risk for a specific policy year. For example, if premium rates are inadequate, the expected loss ratio probably exceeds the required level of 60% or 65%; in this case, the minimum level offers less than full assurance of sufficient funds to pay losses, but it provides some protection against overly optimistic reserve estimates or attempts to overstate statutory earnings in these lines through reserve manipulation.

3. Mortgage Guaranty Insurance

When the mortgage insurance industry was revived in 1957, the state of Wisconsin established a requirement for a contingency reserve to provide for losses that might occur under adverse economic conditions, such as those of the 1930's. The reserve requirements have evolved over time. Currently contributions to the contingency reserve equal to 50% of earned premium are specified, and these contributions have to remain in the reserve for 120 months, or unless the calendar-year loss ratio exceeds 35%. In that event, the contingency reserve could be taken down on a first-in, first-out basis, in amounts equal to losses greater than 35% of earned premium.[30] This statutory definition of the contingency reserve has been adopted in other states where mortgage guaranty insurance is written.* The Wisconsin regulation, however, is unique in requiring that contributions to the reserve be deducted from income; other states merely define the reserve as liability, and companies have adopted the practice of treating it as an adjustment to surplus.

The California statute, adopted in 1961, limited the total aggregate risk exposure an insurer can underwrite to 25 times the total of its capital, surplus, and contingency reserve. This risk ratio has also been adopted by other states. The aggregate risk exposure is equal to the outstanding loan balance multiplied by the coverage percent. For pool products, the cap on total losses and/or the company's participation level would be included in the calculation of risk. The Federal Home Loan Mortgage Corporation's eligibility requirements also limit the total aggregate risk exposure of a mortgage guaranty insurer to 25 times its capital, surplus and contingency reserve.[31]

In April 1975, the Wisconsin regulation [Section 14(b)] was modified to require a mortgage guaranty insurer to contribute a minimum of 0.125% of its outstanding loan balance to the contingency reserve. This is equivalent to 50% of a renewal premium of 0.25% (which traditionally has been charged for individual residential mortgage insurance products). While this regulatory requirement explicitly relates the contingency reserve calculation to the amount at risk, it does not reflect variation in coverage or in loan-to-value ratio, both of which influence risk.

The proliferation of mortgage pool insurance products and the industry's price competition in recent years has led a number of states to revise their statutes and regulations relating to mortgage insurance products. California, Illinois, and New York had enacted revisions by January 31, 1981, and modifications are under consideration by the Wisconsin Insurance Department. Key features of different regulatory requirements are summarized in Table 4.

a. California

The California Administrative Code[32] was revised to incorporate the following changes for mortgage insurance pool products:

- Coverage for individual loans is limited to 25% for any one insurer (though the pool can be insured collectively for up to 100% of an individual loan).

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* There are some differences among the state laws. For example, North Carolina requires that the reserve be held for 180 months; other states have different loss-ratio trigger levels for taking down the reserve.

TABLE 4

STATUTORY REQUIREMENTS FOR MORTGAGE INSURANCE RESERVE AND SURPLUS

	Liability to Surplus	Contingency Reserve	Coverage	Total Loss CAP	Minimum/ Maximum Value	Other
Individual Policies						
Wisconsin	25:1	.125% of Outstanding Balance	Up to 25%	Not Applicable	– FNMA/FHCMC	—
Other	25:1	50% of Earned Premium			– Company Policy	LTV $<$ 95%[c]
Pool Policies						
California	25:1	50% of Earned Premium	Up to 100% for Pool[a]	5%	$5 Million Minimum $\geq$ 75 Loans	LTV $<$ 80%
Illinois	25:1 $\leq$ 10% Surplus, One Lender $<$ 25% of Total in Pools	1% of Net Liability Annual Contribution	Up to 100% for Pool[a]	No Limit	$5 Million Minimum $\geq$ 100 Loans	$<$ 20% loans, 90-95[b]
New York	25:1	50% of Earned Premium	Up to 100% for Pool[a]	10%	$5 Million Minimum $\geq$ 75 Loans	LTV $<$ 80%[b]
Potential Wisconsin	Varies with Coverage	Varies with Coverage	Up to 100% for Pool[a]			

a. No individual carrier can have more than 25% of the pool.

b. May be insured down to 75% by primary, individual coverage.

c. Some states.

- The loans in the pool must have loan-to-value ratios at or below 80%.
- The pool must have a minimum value of $5 million for a minimum of 75 loans.

While it would seem that a 5% cap would limit total losses, it should be noted that the cap is roughly analogous to the depression-level loss experience. One in eight mortgage loans written from 1925 to 1929 defaulted with an average loss severity of 40%, which is equivalent to a 5% aggregate loss.

b. Illinois

The Illinois rule[33] was the first to relate the contingency reserve for pool products to risk and includes the following provisions:

- The contribution to the contingency reserve is set at 1% of net liability.
- An insurer's total liability for mortgage pool insurance on mortgages from any one lender shall not exceed 10% of the insurer's surplus, including the contingency reserve.
- An insurer's total liability for mortgage pool insurance shall be no more than 25% of the company's total mortgage insurance liability.
- Coverage for individual loans is limited to 25% for any one insurer (though the pool can be insured collectively for up to 100% of an individual loan).
- The size of the pool must be a minimum of $5 million for a minimum of 100 loans.
- No more than 20% of the loans can have loan-to-value ratios of 90%-95%; however, primary insurance can be purchased to reduce the risk on individual loans.

While no loss cap is specified in Illinois statutes or regulations, the formula for contingency reserve could effectively encourage establishment of a cap to limit liability. Since no pool insurance had been written in Illinois between the passage of the amendment to the Department of Insurance Rules in September 1979 and the date of this writing, the cap level that might emerge in practice is unknown.

c. New York

The New York regulation[34] is similar to California's, with the following differences:

- The total loss cap is set at a maximum 10%.
- The loan-to-value ratio for loans in the pool must not exceed 80%; however, primary insurance coverage can be purchased to reduce the risk on individual loans to under 80% and make them eligible for pool coverage.

d. Wisconsin (Under Consideration)

Changes being considered for the Wisconsin Administrative Code would adjust the current contingency reserve calculation, described above, and the liability-to-surplus ratio to account for different coverages, loan-to-value ratios, and aggregate loss limits found in pool insurance products. Figure 1 illustrates the modification under consideration to relate the contribution to the contingency reserve to alternative coverage ratios and aggregate loss caps for three different ranges of loan to value. Aggregate loss caps in excess of 5% do not serve to limit the aggregate loss potential below depression levels. Thus, the existence of a cap with no coverage limit results in a higher contribution to the contingency reserve than the same portfolio with a coverage limit. At higher caps and coverages, the loss potential approaches an unconstrained level and, thus, the contingency reserve factors converge.

4. Implications for Contingency Reserve Formulas

The formulas for regulatory reserves are designed to assure solvency and to protect policyholders. As such, the formula should consider the potential exposure under the policy but ignore factors that could lead to loss mitigation. The requirement that regulatory reserves for life insurance products ignore lapse rates or other voluntary terminations is a case in point: this basis is appropriate to establish a contingency reserve for mortgage guaranty products. The policy or the pool of mortgages should be evaluated over the policy life without consideration for mortgage terminations through sale of property or nonrenewal on the part of the lender. Further, the amount of claim payable under the policy should be calculated without consideration for loss mitigation that may be achieved through property acquisition and resale.

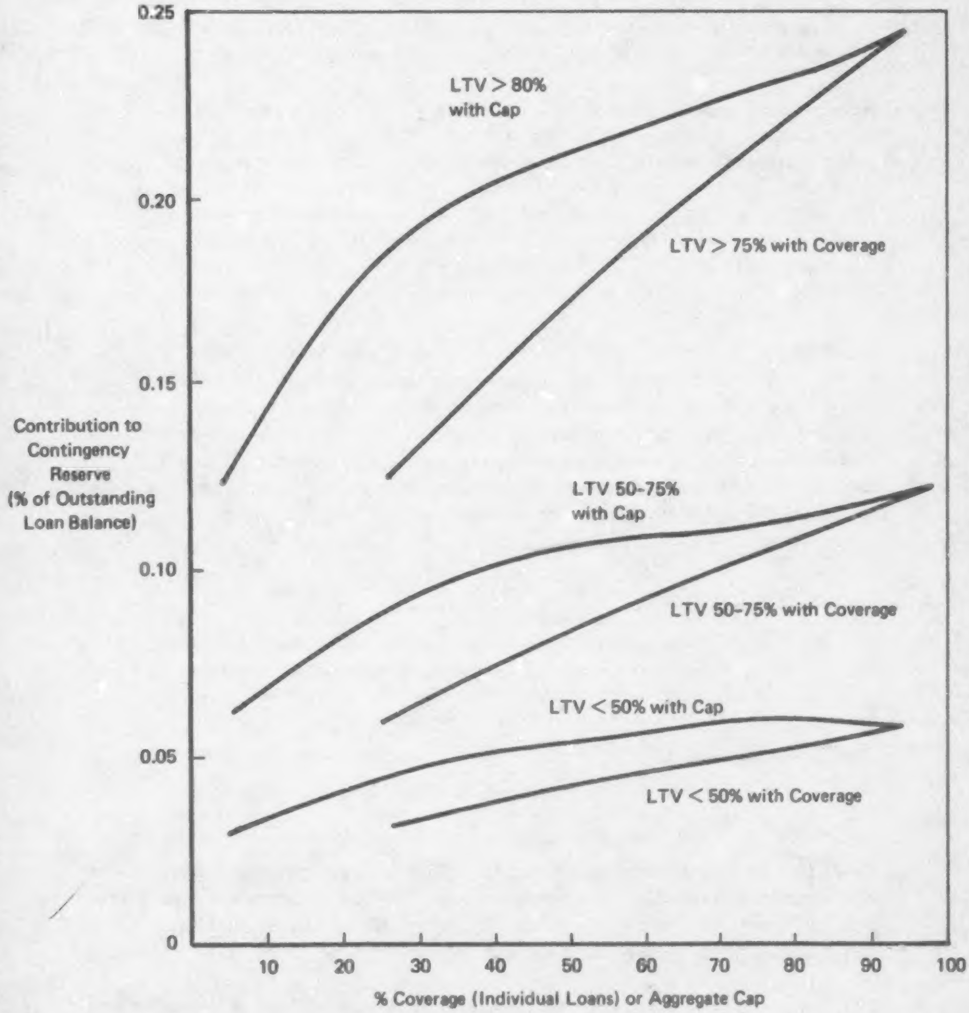
Regulatory requirements for mortgage guaranty contingency reserves are in an evolutionary stage. If revisions in recent years are any indication, further efforts will be made to relate the calculation of the contingency reserve to both risk and the risk ratio. This would be in keeping with the original intent of the regulatory requirement and with sound economic reasoning.

B. NATURE OF THE INSURANCE PRODUCT

Mortgage insurance provides long term protection for the lender or investor in the mortgage against a default by the borrower. The reserve requirements reflect the unique aspects of this product.

1. Policy Structure

Mortgage guaranty insurance is rate-guaranteed and noncancellable, i.e., it is guaranteed renewable at rates stated at the inception of the policy. The lender has the option to cancel or not renew, and many lenders establish amortization levels below which they no longer require insurance. Thus, the product creates the opportunity for adverse selection which may increase over the life of any portfolio of insured mortgages. The fact that a mortgage insurance policy is guaranteed renewable at a definite rate is one of the factors necessitating the establishment of a



LTV = Loan-to-Value Ratio

FIGURE 1 REVISIONS UNDER CONSIDERATION FOR THE WISCONSIN CONTINGENCY RESERVE FORMULA

significant contingency reserve. The reserve protects not only against catastrophic experience but also against a decrease in the quality of the insurance portfolio that develops naturally through adverse selection on renewal.

The most common premium structure calls for a first-year premium on individual products which ranges from 0.5% to 1.25% of the outstanding loan balance and a renewal premium of 0.25%. The portion of the first-year premium in excess of twice the renewal premium can be earned according to the schedule for a ten-year, single premium policy. The premium pattern does not correspond to the expected pattern of normal loss, in which losses peak in the second through fourth year; thus, the contingency reserve also serves a function similar to the active life reserve for disability income products or the policy reserve in life insurance products.

2. Losses

Disruptions in the earning power of the borrower, such as from loss of job, divorce, or the death or disability of the primary wage earner, represent the credit risk associated with mortgage loans. The property risk on the loan collateral also contributes to default, since a borrower in financial difficulty will be less able to sell the property and avoid foreclosure if the property has not maintained its value. Both credit risk and property risk are influenced by local and national economic conditions.

Mortgage insurance losses can be placed into three categories:

- Normal losses associated with regular business cycles, interruptions in the borrower's earning power, and random errors made in underwriting.
- Localized widespread default caused by adverse local economic conditions.
- National, widespread default caused by a severe depression in the economy.

The last category has no analogy in any other insurance line and is the equivalent of a widespread catastrophe.[35] The mortgage guaranty contingency reserve was established to deal with both the second and third categories of loss. (As discussed in this and other sections, however, the reserve also serves other important functions.)

The potential for mortgage defaults is dependent upon the business cycle and related fluctuations in unemployment, interest rates, and the housing market. Thus, the loss cycle for mortgage insurance products is correlated with the business cycle and would be particularly sensitive to a combination of high unemployment and a depressed housing market.

In a previous study,[14] Arthur D. Little, Inc., found a normal loss frequency during the period 1964 to 1972 of about 1.1% for privately insured mortgages with loan-to-value ratios from 80% to 90%, and estimated a loss incidence twice as high for 90% loans. MGIC's historical loss frequency on 80% loans between 1957 and 1972 was 1.6%.[36] Thus, the aggregate incidence of normal loss experienced from 1957 to the mid-1970's was about 1% to 3% of policies written.

The FHA recently published an analysis of terminations and defaults by state for mortgages insured under Title 203 programs.[37] For the total U.S., the ultimate claim rate was 6.95% for 30-year loans insured by policies issued from 1957 to 1979 (see Table 5). The default rate varied widely among the HUD regions from a low of 2.44% in Region I (New England) to a high of 11.9% in Region VII (Iowa, Kansas, Missouri and Nebraska). Of the ten largest states, five had rates greater than the average. In the states with the highest claim levels, private mortgage insurers also experienced difficulty. These states experienced the second category of losses: widespread, local default. The rate of claims in Florida and Texas was equal to the rate of defaults experienced in the 1930's. During the 1930's, default rates of about one in seven (14%) were experienced on a national scale for mortgages that originated between 1930 and 1934 and rates of about one in eight (12.5%) for mortgages that originated between 1925 and 1929. This level of default, combined with a loss of 40% of mortgage value, resulted in a widespread catastrophe for mortgage insurers and lenders.

The historical pattern of losses and policy terminations in the 1964 to 1972 period indicates that the cumulative loss ratio for 90% loans with 25% coverage would be about 18% through the tenth year of a portfolio, assuming that all claims were settled with the percentage payment option.[14] Figure 2 illustrates what happens to the loss ratio as the claim frequency increases, all other things equal: depression-type default rates (12-14%) translate into an ultimate loss ratio in excess of 200%! Such a devastating risk is virtually unknown in any other line of insurance and is the principal reason for the establishment of a catastrophic loss reserve. Further, ultimate claim frequencies as low as 6% could result in a loss ratio as high as 100% in the absence of any compensating loss mitigation through property acquisition.

A number of local areas and states experienced depression-level default incidence for FHA loans. The rapid escalation (inflation) of home values throughout economic contractions and expansions during the past 20 years, however, has served to mitigate loss severity. Otherwise, the local widespread housing market conditions experienced in Florida and Texas might have had a greater impact on the operating results of private mortgage insurers, perhaps testing their solidity if not their solvency.

At a claim frequency as low as 2% or a loss ratio in excess of 35%, funds held in the contingency reserve would be required to pay losses. This loss frequency is well within the realm of recent experience; an ultimate claim frequency of 6% (a potential loss ratio of 100%) is just below that experienced by the FHA over the past 25 years. Further, the weakened housing market, reduction in the rate of escalation in housing prices during 1980-81, and the continued prospects of high mortgage interest rates strongly suggest that the opportunities for loss mitigation through property acquisition and sale will be sharply reduced in the 1980's. Therefore, in the

TABLE 5

ULTIMATE CLAIM TERMINATION RATE BY REGION FOR SECTION 203 – 30-YEAR TERM LOANS – 1957 THROUGH 1979

Region/State[a]	Ultimate Claim Termination Rate (%)	Estimated Life Expectancy (yr)
U.S. Totals	6.95	13.1
HUD Region I	2.44	12.2
HUD Region II	3.96	15.2
HUD Region III	3.43	14.0
HUD Region IV	9.70	14.3
HUD Region V	7.77	12.8
HUD Region VI	7.93	13.4
HUD Region VII	11.90	13.9
HUD Region VIII	3.31	12.0
HUD Region IX	4.56	11.4
HUD Region X	5.28	12.5
California	3.96	11.3
Florida	14.26	13.8
Illinois	8.23	12.0
Michigan	8.07	13.9
New Jersey	4.92	12.9
New York	4.29	15.5
Ohio	8.90	12.2
Pennsylvania	5.12	13.9
Texas	12.59	14.0
Washington	6.24	12.8

a. States with the largest volume of loans since 1957.

Source: "Survivorship and Decrement Tables for HUD/FHA Home Mortgage Insurance Programs as of December 31, 1979," Actuarial Division, Office of Financial Management, U.S. Department of Housing and Urban Development, September 1980.

years ahead, the contingency reserve probably will be necessary to cover losses during economic downturns far less severe than a 1930's-style depression. For this reason alone, it is necessary for insurers and regulators to provide adequate contingency reserves, even as products and prices change.

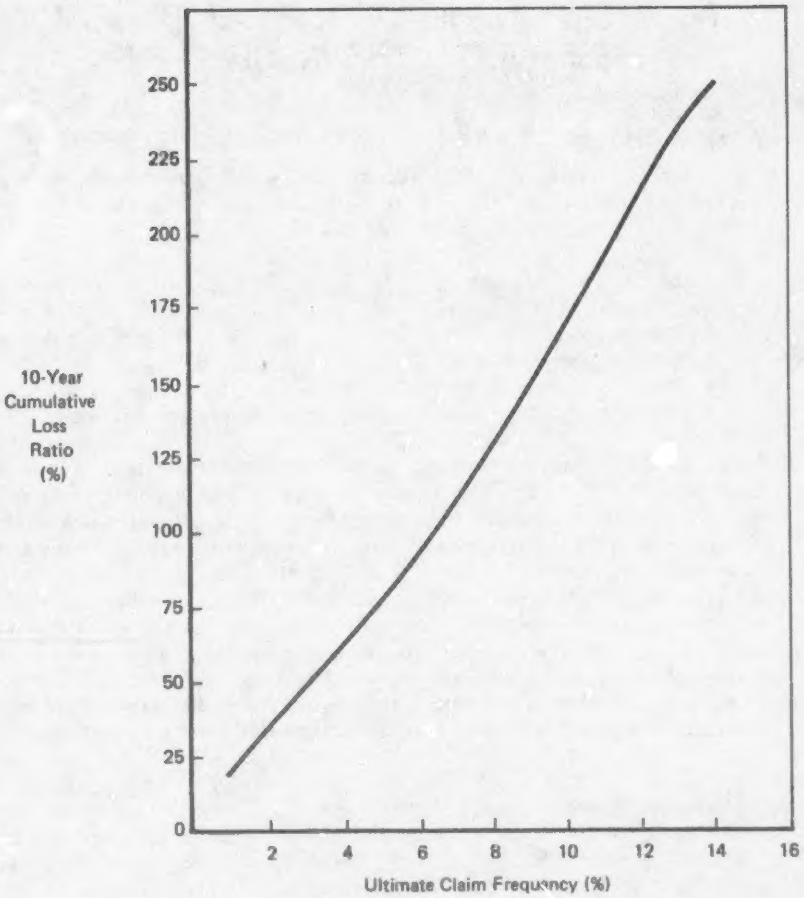


FIGURE 2 EFFECT OF CLAIM FREQUENCY ON LOSS RATIO
(Individual Policies, 90% Loan-to-Value, 25% Coverage,
First 10 Years of Policy)

IV. RELATIONSHIP OF THE CONTINGENCY RESERVE TO THE INSURED RISK

A. RISK CHARACTERISTICS AND CONTINGENCY RESERVE

In a previous monograph,[38] characteristics of emerging mortgage instruments were related to risk characteristics that could influence the propensity of borrowers to default. The major risk elements identified were:

- Negative amortization
- High loan-to-value ratio
- Balloon payments
- Interest rate sensitivity
- Use of a national interest rate index
- Increasing ratio of principal, interest, taxes and insurance to income

A number of emerging mortgage instruments were related to each of these risk factors (Table 6). The only characteristics currently included implicitly in the calculation of premium or contingency reserve are high loan-to-value ratios and negative amortization. The first is incorporated through the practice of using a premium rate for an individual loan that is based upon the highest loan-to-value ratio that the loan achieves. This procedure, however, does not reflect any risk from increasing the loan-to-value ratio over the early years of the mortgage loan, such as is the case with negative amortization. When the renewal rate is applied to the increasing loan balance, there is some increase in premium and contingency reserve with the risk. It remains to be seen, however, whether the risk of default will increase more or less than the outstanding loan balance on these negatively amortizing policies.

Balloon payments, which are not currently covered by mortgage insurance products, were part of the reason for the collapse of the mortgage insurance industry in the 1930's. As long as the policy term is coincident with the mortgage term up to the balloon payment, this will not be a problem. Also, as long as the renegotiated mortgage for the balloon adequately reflects loan-to-value ratio, coverage, and other underwriting criteria, either the premium base or the risk base may be sufficient for contingency reserve calculation.

Neither interest rate sensitivity nor its companion risk factor, use of a national interest rate index, are reflected in premium at present. Thus, they are not reflected even implicitly in the contingency reserve.

Increasing the ratio of principal, interest, taxes, and insurance (PITI) to income is reflected only to the degree that it is related to negative amortization. It is possible, however, that a differential default or loss severity risk will be associated with mortgages that experience increase in PITI over the mortgage term, since there is a demonstrated higher default risk among mortgages with higher PITI-to-income ratios.

TABLE 6

SIGNIFICANT RISK CHARACTERISTICS OF ALTERNATIVE MORTGAGE INSTRUMENTS

Risk Element	Variable Rate Mortgage	Renegotiated Rate Mortgage	Graduated Payment Mortgage	Pledged Account Mortgage	Price Level Adjusted Mortgage	Constant Payment Factor Variable Rate Mortgage	Shared Appreciation Mortgage
Negative Amortization			X		X	X	
High Loan-to-Value			X	X			
Balloon Payment		X[a]			X		X
Interest Rate Sensitivity	X	X			X	X	
National Index	X	X			X	X	X[a]
Increasing PITI to Income	X	X	X	X	X	X	

a. In some proposed versions only.

Source: Arthur D. Little, Inc., assessments.

Mortgage pool products generally are designed for the portion of the loan balance below 80% of the original property value and are often subject to some aggregate loss limit. Some of the premium rates that have been charged for pool products, however, are far below what would appear to be justified by the lower loan-to-value ratios (Table 7), especially in view of the requirement in some states that the insurer underwrite each loan individually. Thus, potential premium inadequacy can be added to the list of risk elements.

TABLE 7

MORTGAGE INSURANCE POOL POLICY ILLUSTRATIVE RATES

Pool	(1) State	(2) Pool Value ($ million)	(3) Date	(4) Aggregate Loss Cap (%)	(5) Primary Rate (Basis Points)
Bank of America	CA	151	09/77	5	10.0
First Federal of Chicago	IL	75	10/77	5	11.0
Citizens Bank of Oregon	OR	1	10/78	5	10.5
Rock Island	IL	17	11/78	10	17.4
Bank of America	CA	28	05/79	5	9.5
Glendale Federal	CA	61	06/80	5	6.0
Wisconsin HFA	WI	45	07/80	10	3.5
South Dakota HFA	SD	210	07/80	10	0.1
Minnesota HA	MN	226	07/80	10	0.1
East Baton Rouge	LA	107	09/80	15	2.5
St. Cloud	MN	9	08/80	20	1.3
Nebraska HFA	NE	40	12/80	10	3.5
St. Louis HA	MO	20	12/80	10	0.45
Rhode Island HFA	RI	100	12/80	10	0.1
Aurora, CO	CO	48	12/80	10	0.3
Brevard County, FL	FL	125	02/81	15	0.25

Source: Individual mortage insurance companies.

Since many of the risk elements identified for new mortgage products are not totally or explicitly incorporated in the premium calculation, they are not reflected in the contingency reserve calculation, even under the current Wisconsin regulations. A rate inadequacy problem that may be encountered in mortgage pool products is not reflected in a reserve calculated on the basis of the premium charged. If the contingency reserve were to consider new risk elements explicitly, the formula would have to be adjusted by factors that reflected the differential risk (Table 8). For the risk elements related to alternative mortgage instruments, it would be necessary to develop factors for the relative change or increase in: (a) outstanding loan balance from negative amortization, (b) loan-to-value, and (c) PITI-to-income ratio. Additional factors would be needed to reflect the risk from interest rate variability. Unfortunately, there is inadequate experience today from which to generate appropriate factors to reflect these risk elements. Thus, it is all the more important for the contingency reserve to provide for the additional risks associated with alternative mortgage instruments.

TABLE 8

RISK CHARACTERISTICS RELATED TO CONTINGENCY RESERVE BASE

		Reflected in Contingency Reserves?	
Risk Element	**Reflected in Premium?**	**Premium Base**	**Risk Base**
Negative Amortization	Somewhat – highest LTV plus % LB	Somewhat	Factor for relative increase
High Loan-to-Value	Highest LTV is premium	Yes	Differential factor for LTV
Balloon Payment	Policy coterminous with initial term	Not applicable	Not applicable
Interest Rate Sensitivity	No	No	Factor related to change
National Interest Index	No	No	Factor related to change
Increasing PITI to Income	Negative amortization only	Negative amortization only	Factor related to change
Inadequate Premium	–	No	Factor related to liability

Source: Arthur D. Little, Inc., assessment.

The risks associated with inadequate premiums for pool products consisting of conventional mortgages with fixed interest rates and level premium can be partially addressed through contingency reserve formulas based on liability, such as required by the Illinois statute. An insured liability is determined by coverage, level of participation, the risk characteristics of loans in the pool and any aggregate loss limitation.

B. COMPARISON OF LIABILITY AND RESERVE CALCULATION BASES

For individual mortgage insurance products, the contingency reserve is established as 50% of earned premium in every state but Wisconsin, which requires a contingency reserve equal to the greater of 0.125% of the outstanding loan balance or 50% of earned premium. The pricing of products for mortgage pools reflects a major departure from the relationship between premium and outstanding loan balance. As discussed above, in recognition of this, some states have amended or are entertaining amendments to current statutes or rules for contingency reserve contribution, risk-to-capital ratios, and liability limits. Inasmuch as mortgage insurers establish reserves in accordance with state requirements, differences in state regulations could result in different levels of contingency reserves supporting similar portfolios of insured mortgages.

For individual policies, the Wisconsin requirement partially reflects risks by tying the contingency reserve contribution to outstanding loan balance. It does not reflect differential risk from different loan-to-value ratios or coverages, however. Thus, the reserve will differ among states for individual policies only if the premium falls below .25%. The reserve level established for pool policies can differ significantly, depending on whether the Illinois or another statute or regulation (e.g., California's) applies.

1. Individual Policies

Figure 3 compares the contingency reserve over the policy life based on the 50%-of-premium formula, with the minimum level required in Wisconsin, under alternative rate scenarios for individual policies with 95% loan-to-value and 25% coverage (part a) and 86% loan-to-value and 20% coverage (part b). The assumed premium rate for the 95% loan-to-value policy is 1% of the outstanding loan balance for the first year and 0.25% on renewal. For the 86% loan, the assumed rates are 0.5% of the outstanding loan balance in the first year and 0.25% on renewal. As Figure 3 illustrates, the current Wisconsin regulatory scheme provides for a minimum contribution on an individual policy that is just below that which would be contributed for an 86% loan-to-value policy with 20% coverage.

A comparison of parts A and B of Figure 3 illustrates that the minimum contribution specified in the regulation does not differ between the 95% loan-to-value policy with 25% coverage and the 86% loan-to-value policy with 20% coverage. Thus, the Wisconsin rule does not fully reflect differential risk among policy types. Since it requires the greater of 0.125% of the outstanding loan balance *or* 50% of earned premium, the contingency reserve contribution reflects differential risk only to the extent that the risk is reflected in premium rates, subject to a minimum based upon traditional rates charged for 95% loan-to-value policies. Thus, if the first-year of renewal premium falls below 0.25% of the outstanding loan balance, the Wisconsin rule would require a greater contribution to the contingency reserve than other states for individual policies. At a premium rate as low as 50% of current rates, there would be a substantial difference between the Wisconsin minimum and the contingency reserve established in other states.

2. Pool Policies

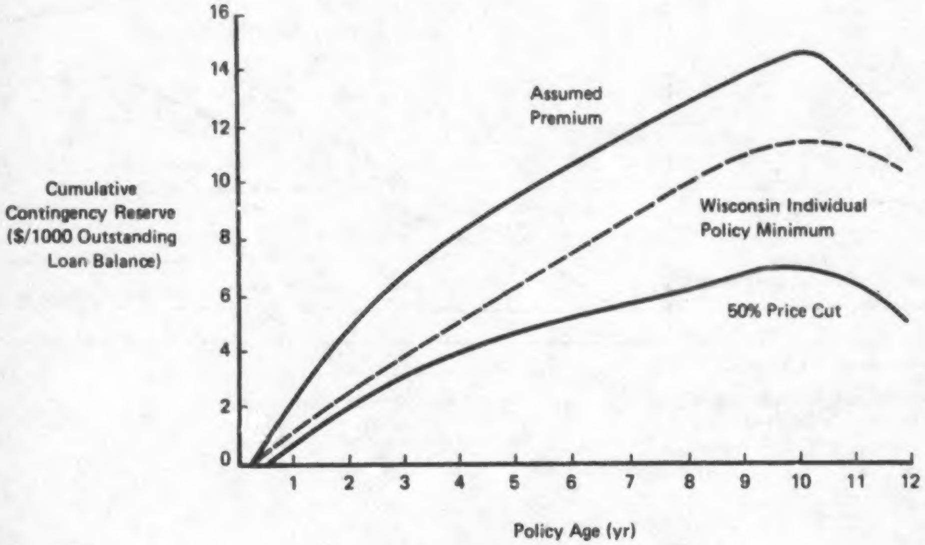
The contingency reserves for mortgage pool policies differ, depending on the state regulations that apply. Calculation of the contingency reserve for a sample pool policy illustrates this point. The pool has the following characteristics:

- Outstanding loans of $100 million;
- 86% loan-to-value;
- 100% coverage for the pool;
- An aggregate cap of 5%; and
- Premium equal to 3.5 basis points.

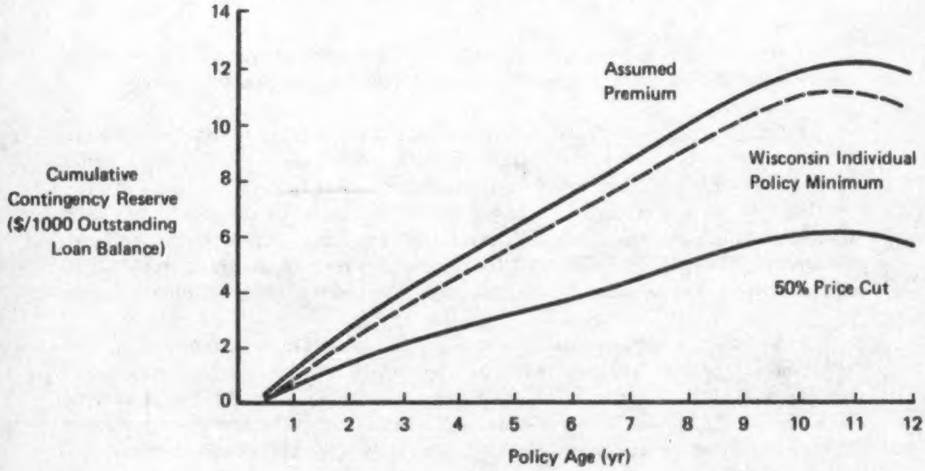
Since participation by individual insurers in Illinois, California, and New York is limited to 25% of a pool, there must be a minimum of four participants in a pool that offers 100% individual policy coverage; however, the aggregate contingency reserve for the entire pool has been calculated in these examples.

Figure 4 depicts the level of contingency reserve over the first 12 years of the pool life for three different formulas:

- 50% of earned premium;
- Illinois rule; and
- Wisconsin revisions under consideration.



A. 95% LTV, 25% Coverage



B. 85% LTV, 20% Coverage

FIGURE 3 INDIVIDUAL POLICY PREMIUM BASE VERSUS RISK BASE

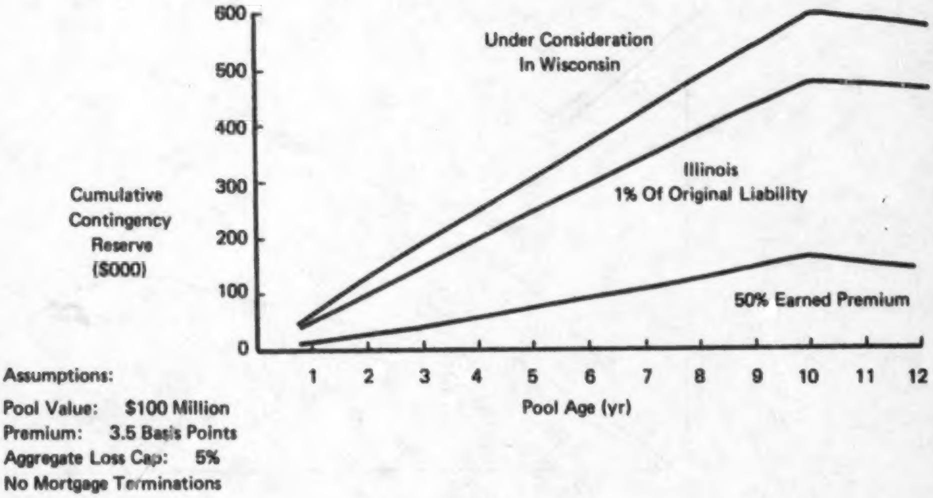


FIGURE 4 SAMPLE POOL POLICY CONTINGENCY RESERVE UNDER ALTERNATIVE STATUTES

When the contingency reserve is equal to 50% of earned premium, it grows from $35,000 in the first year to a maximum of $165,600 in the eleventh year.

For the Illinois method, the contribution to the contingency reserve is not linked to the premium, but to the total liability. For the pool example, the liability is equal to $5 million ($100 million × 0.05). At 1% of the outstanding liability per year, the contingency reserve contribution is $50,000 in year one. In contrast to the 50% earned premium method, the Illinois calculation exceeds premium written and premium earned every year. In year 10, the contingency reserve has grown to $476,350, almost three times as large as the balance of the reserve under California rules.

The method under consideration in Wisconsin is even more stringent than that of Illinois for pools with aggregate loss caps below 10%. First-year contribution to the reserve is $62,500, or three and one-half times the contingency reserve calculated as 50% of premium earned for a rate equal to 3.5 basis points. The contingency reserve in year 10 reaches a maximum of $595,900, higher than any of the other methods.

The Wisconsin formula under consideration would generate the same contingency reserve as the earned premium method for the sample policy if the premium rate were 12.5 basis points. The Illinois formula would generate the same contingency reserve as the earned premium method for the sample policy if the premium rate were 10 basis points. At 3.5 basis points, insurers who wished to underwrite

Illinois or Wisconsin pools would be required to make contributions from surplus or additional paid-in capital to satisfy the contingency reserve requirements.

Some additional protection may be afforded to investors in securities backed by pool policies by limiting the risk ratio for pool business. For example, Standard and Poor requires that the risk ratio be no greater than 7 to 1 for mortgage securities backed by insurance as a condition for rating the security. In addition, the proposed revisions to the Wisconsin regulations relate the risk ratio allowed for pool policies to coverage levels and aggregate loss caps.

V. RELATIONSHIP OF RESERVES TO SOLVENCY AND SOLIDITY

Solvency implies the ability of an insurer to meet obligations for claim payments and other costs when due. At a minimum, an insurer's assets must exceed the value of its liabilities to be considered technically solvent. Solidity is a broader concept and indicates the ability of a company to continue normal business operations (i.e., to continue to offer new and renewal policies) and remain solvent over some period of time. The duration of the time period or conditions that are used to measure solidity depend on the characteristics of the insurance product.

In previous studies of the mortgage insurance industry, solvency has been measured by evaluating whether an individual company[39] or a representative company[14] could withstand different degrees of economic adversity, up to and including depression-level defaults and losses. These studies concluded that a mortgage guaranty company, writing individual policies covering standard mortgages at prevailing prices and adhering to statutory accounting and reserving practices and to certain investment practices, could withstand economic conditions up to the severity of a 1930's-style depression.

Insurance reserves are but one of several factors that influence the solidity and solvency of insurance companies. Capitalization, rate adequacy, and other factors, such as the nature and quality of investments, are also related directly or indirectly to solvency. If premium rates and investment income do not cover losses and other expenses, the company must fund the latter from surplus and other sources. Under these conditions, capital will leave the business for lack of adequate return. Unsound investments could impair the assets and reduce the overall profitability of the company. If reserves are inadequate, those obligations must be funded from surplus. If surplus is inadequate to absorb fluctuations in losses and assets that might occur over the long term, then the firm's solidity is in doubt.

A. CONTINGENCY RESERVE AND TOTAL CAPITAL

In the mortgage insurance industry, the surplus and contingency reserve are appropriately considered together as the capital base. The mortgage insurance industry's analogy to the premium-to-surplus ratio is the risk ratio: outstanding liability divided by the sum of the contingency reserve plus policyholders' surplus. The maximum permitted risk ratio, as specified in state insurance laws and regulations, is 25 to 1, which means that the sum of the contingency reserve and policyholders' surplus must be at least 4% of the mortgage insurer's liability exposure. (Liability exposure is determined by applying the policy coverage for individual mortgages and the aggregate loss cap for mortgage pools to the outstanding loan balance insured.)

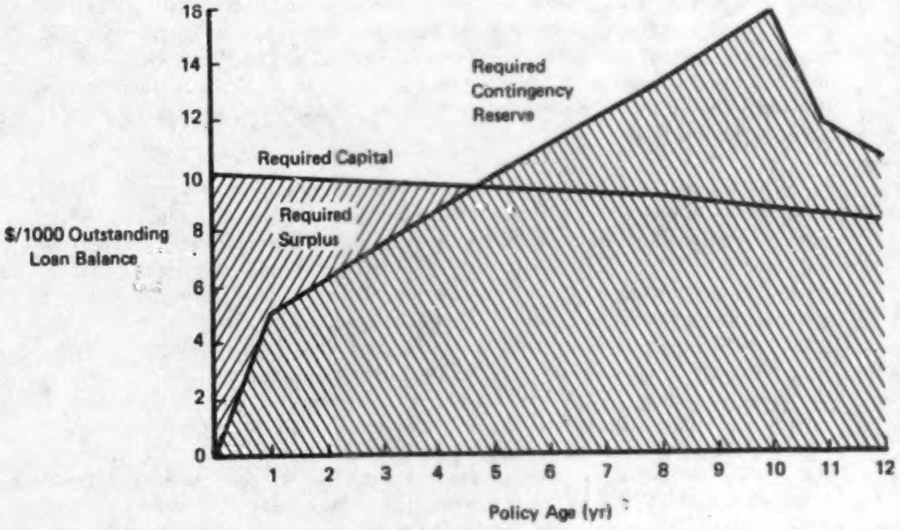
The inclusion of both the contingency reserve and the policyholders' surplus in the regulatory risk ratio means that the relationship between the two is explicitly recognized for mortgage insurance companies. Further, changes in the contingency reserve level that arise from premium differences must be offset through higher levels of required surplus in order to meet the risk ratio. Supplementing the contingency reserve through higher levels of required surplus, however, results in less capital available over all, other things being equal. This, in turn, would constrain the ability of companies to write new business or to respond to new product opportunities.

The degree to which the contingency reserve supplies the total capital to satisfy risk ratio requirements for individual policies or pool policies will differ, depending upon the contingency reserve formula, the premium and the risk ratio. An individual policy with a 25% coverage initially requires capital equal to at least 1% of the outstanding loan balance (4% × 25% coverage = 1%), or $10 per thousand dollars of outstanding loan balance (Figure 5). As the outstanding loan balance on the mortgage declines, the capital required declines accordingly. In this example, the first-year premium is assumed to be 1% and the renewal premium 0.25% of the outstanding loan balance. Thus, if the contingency reserve is specified as 50% of earned premium, it will constitute one-half of the required capital by the time the policy is one year old if the premium is fully earned in the first year. By the fifth year, the contingency reserve alone satisfies the risk ratio; beyond that point, it exceeds required capital. The excess of contingency reserve over the level of required capital enables the insurer to operate at a lower risk ratio or to support additional business.

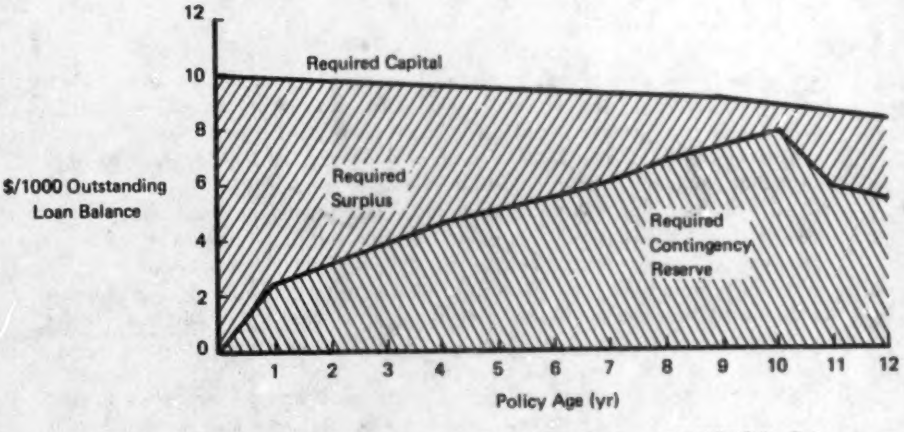
If the same policy experiences a 50% price reduction, the required capital does not change (Figure 5b). In this case, however, the level of the contingency reserve is less than the required surplus until later years in the policy life, when the annual amortization of the loan exceeds the annual takedown of the contingency reserve. In this situation, the mortgage insurer would require continued infusion of new surplus to write additional business.

While the pattern of contingency reserve and required capital for individual policies at current pricing causes the level of the contingency reserve to meet the level of capital in the early years of the policy, this may not be the case for pool policies. For a risk ratio of 25 to 1 for a pool policy, the contingency reserve can be lower than the level of required capital for most of the policy life. For a pool policy with a 5% loss cap and a premium equal to 3.5 basis points, the contingency reserve does not reach the required capital ratio during the first 12 years of the policy (Figure 6a) if the contingency reserve is specified as 50% of earned premium and no mortgage terminations occur. The Illinois formula for contingency reserve would produce a pattern similar to that for individual policies: the contingency reserve would meet the level of the required capital after about four years.

If a Standard and Poor's rating is desired for a security backed by insured mortgages, mortgage insurers must provide capital at at least a 7 to 1 ratio. For the pool policy example in Figure 6, none of the contingency reserve formulas discussed for pools would enable the contingency reserve to meet or exceed this risk ratio level during the first 12 years of the policy life. However, application of Wisconsin's requirement for individual policies or a contingency reserve annual contribution equal to 0.125% of the outstanding loan balance would result in a contingency reserve level equal to required capital by the sixth year of the pool.

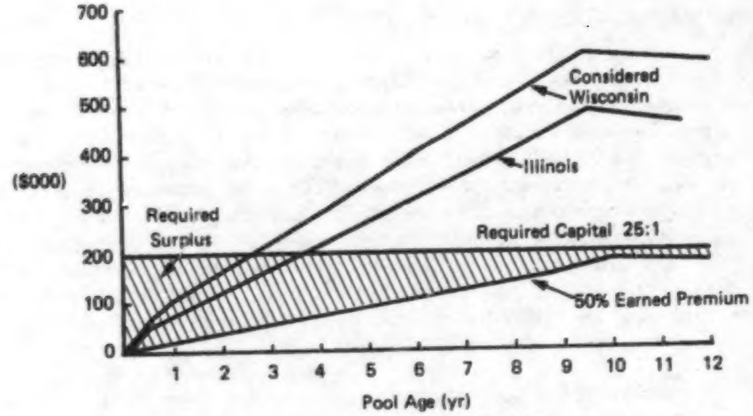


A. Individual Policy: 95% LTV, 25% Coverage

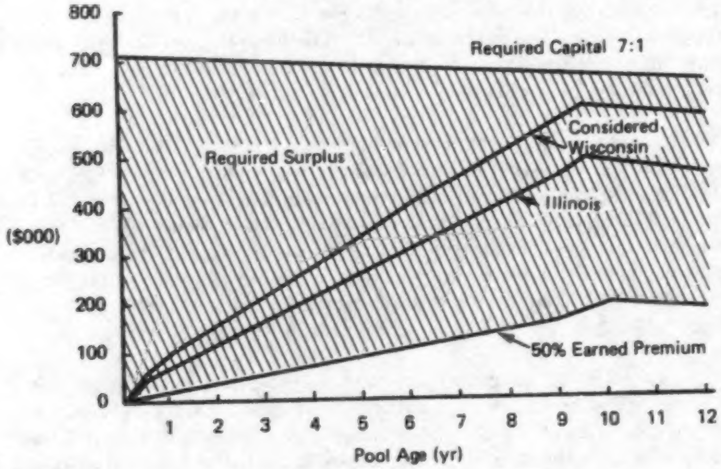


B. Individual Policy: 95% LTV, 25% Coverage with 50% Price Cut

FIGURE 5 CONTINGENCY RESERVE AND REQUIRED CAPITAL



A. With Required Capital 25:1



B. With Required Capital 7:1

Assumptions:

Pool Value: $100 Million
Premium: 3.5 Basis Points
Aggregate Loss Cap: 5%
No Mortgage Terminations

FIGURE 6 EXAMPLE POOL POLICY CONTINGENCY RESERVE AND REQUIRED CAPITAL

B. IMPLICATIONS FOR SOLIDITY

Policy pricing and contingency reserve formulas that result in a cumulative level of contingency reserve that fails to meet or exceed the level of required capital have adverse implications for industry profitability and solidity. If one assumes that normal losses plus underwriting expenses are 50% of premium, the cumulative after-tax GAAP underwriting profit would be about one-half of the cumulative contributions to the contingency reserve. Thus, if the contingency reserve replaces capital in four years, the ultimate after-tax payback period would be about eight years. Without consideration for the time value of money (i.e., the fact that a dollar of initial required surplus in year one is worth more than a dollar contributed by the premium received in year ten) and neglecting the fact that investment income is earned on about half of the contingency reserve,* the payback period implies a return to capital of only about 12.5%.

For a pool policy, the contingency reserve may reach the required capital level only in the later years of the pool, when the rate of principal amortization exceeds the rate of decline in the level of the contingency reserve. In the pool example described above, the contingency reserve will equal the required capital in the fourteenth year of the policy for a risk ratio of 25 to 1. Even if normal losses are zero and half of the premium is sufficient to cover underwriting expenses, the implied return to capital in this case is considerably less than 7%.

If capital employed in a business does not earn a risk-commensurate rate of return, it will leave that business. Current pricing levels on mortgage pools do not appear sufficient to retain and attract capital for that business and thus could hinder the continued capacity to underwrite those products. While the risk ratio may partially compensate the investor in the mortgages for an inadequate contingency reserve, it necessitates greater levels of surplus to support an insurance portfolio which is producing a lower return for the mortgage insurance company stockholder.

One aspect of insurance solidity is the prospect for continuing existence and availability of insurance products. The pricing and resulting contingency reserve levels established for pool policies raise doubts about the solidity of that product line. Solidity would be enhanced by imposing a stricter risk ratio for pool products, using a contingency reserve formula tied to liability, and limiting the proportion of a mortgage insurer's business that is pool insurance.

Today, individual policies are the dominant portion of the mortgage insurance industry's insured loan portfolio. Most of the insured mortgages are the standard fixed-interest, level-payment types. The product-pricing and reserving practices for this part of the mortgage insurance business has not changed since the early 1970's. Thus, the overall conclusions reached in earlier studies about industry solidity still hold. New products developed for alternative mortgage instruments and for pool policies, however, must have reserves established in accordance with economic and statutory principles of solvency and conservatism to maintain industry solidity in the future. It is not clear that these problems have been appropriately analyzed or that necessary adjustments in reserving methods have been instituted.

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* Tax and loss bonds that do not earn interest must be purchased in an amount equal to the potential income tax liability deferred when reducing taxable income by the contribution to the contingency reserve.

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Senator **Proxmire**. Mr. Gourley, I know you have laryngitis, so I'm hesitant about this, but I'd like to have you and Mr. Snyder comment on this if you would.

I understand the administration would expand FHA's insurance activity to include variable interest rate and shared depreciation loans and reduce the overall amount of insurance that could be provided.

IMPACT ON FHA INSURANCE FUNDS

Wouldn't that tend to move FHA toward more risky loans which could have an impact on the FHA insurance fund and require higher insurance premiums that the consumers would have to bear?

Mr. **Gourley**. May I start and I'll see how long my voice holds out and I'll try to make it brief again and I would like, if I might, walk back to the previous question you asked Mr. Waldo. I know you didn't ask me this, but I think that Bob made a comment that I think is very pertinent in answering the question about the availability of money FHA and the GNMA program and conventional market being able to pick up and in effect close the gap between the two.

Right now, as Bob said earlier, there is nothing in place yet that would make conventional financing so readily available that it would replace the GNMA structure, and there are lots of things such as the problem of pension funds which cannot legally invest in most conventional instruments, which means that at present there's not a real strong market for conventional loans as there will be in the not too distant future, I'm sure. Right now is not the time to cut out the FHA or GNMA programs because of that market place problem, and part of the report of the GAO speaks specifically to that.

I think the private insurance companies are very strong and have the ability to insure a tremendous amount of loans, and I feel very comfortable as an industry, the mortgage banking industry—but they can't insure unless there's a market place out there for the conventional loan and right now, with the problems we have, is not the time to cut back on FHA and GNMA.

To answer your question on the alternative mortgage instruments, the SAM's and the ARM's, they presently are being tested. I think FHA needs the right to get in these particular fields, but I think that it would be incumbent upon HUD to move carefully and slowly into them as these programs develop. Fortunately, many institutions have already begun the alternative mortgage instruments. We are feeling our way along. Both FNMA and FHLMC are involved and I think that we will have enough experience soon that HUD can benefit from that and be involved in those programs that are not that risky.

Senator **Proxmire**. So you don't see a problem with the fact that you're expanding the area of coverage to include variable interest mortgages and shared depreciation loans and at the same time reducing the overall amount of insurance that we can provide?

Mr. GOURLEY. Well, I'm very strongly against reducing the amount of insurance that could be provided. You mean capping the FHA insurance program?

Senator PROXMIRE. That's right.

Mr. GOURLEY. That's one of the mortgage bankers' position very clearly, that if these kind of programs work, that's even more reason for the ceiling on the amount of FHA insurance to remain high enough to accommodate, but it needs to stay up to help that happen.

Senator PROXMIRE. Mr. Snyder?

Mr. SNYDER. Senator, we, too, would continue to support FHA broadening their offerings, however, maintaining their insurance limits as they are now.

As you said, however, at the same time, we think that the 30-year fixed rate mortgage should be the leader in FHA's portfolio.

Senator PROXMIRE. Mr. Snyder, the administration is interested in targeting FHA insurance for first-time home buyers and inner-city residents and proposes expansion of FHA to variable rate mortgages and other alternative instruments to advance this goal. In your view, does FHA underserve these groups now?

Mr. SNYDER. No, I don't believe they underserve the groups. I think perhaps what we're experiencing today is because of economic conditions being what they are there's a need to expand the program, but I don't think there has been a shorting of anybody in the past.

Senator PROXMIRE. Mr. Pryde?

Mr. PRYDE. Well, if I understand your question, whether HUD is adequately serving the first-time homebuyer and inner-city population.

Senator PROXMIRE. What I was asking about is that the administration wants to expand FHA's insurance activity. They want to include variable interest rates and shared depreciation loans—I'm sorry, that wasn't the question.

The question was, the administration is interested in targeting FHA insurance to first-time home buyers and inner-city residents, and proposed to expand their variable rate mortgages and other alternative instruments in that direction. The question is, does FHA underserve these groups now? Do they need additional service?

Mr. PRYDE. Well, I think there is a question whether they are underserved more than the majority of the population and I would not necessarily agree with our fellow friend, the realtors, that they are.

Senator PROXMIRE. You would agree that the administration is right in trying to target more of the FHA insurance to first-time homebuyers and inner-city residents; is that right?

Mr. PRYDE. Well, first-time homebuyers are a critical problem in the country, and I think there's a question of whether FHA should do that and pursue that more than they have in the past.

Mr. GOURLEY. Mr. Chairman, might I interject here, too, that I think FHA has done an excellent job in serving the first-time home buyers and that is where a tremendous amount of FHA's insurance goes now, to take of that person who's buying their first home. So I think that's really why FHA is so important and targeting it doesn't help at all. I think the statistics would prove out that that's really what it serves today and certainly there's an additional part of the market served by FHA, but a major important part of that market is the first-time home buyer.

I think the delivery system is the only thing that really slows down the FHA, the use of funds in the inner city. We have no problems in those areas where we have offices who are active originators of FHA loans. The problem is, in many instances, that there are not people there that are active users of the program.

Senator **Proxmire**. So you think the FHA at the present time is already targeting the inner cities?

Mr. **Gourley**. Well, I think targeting would not be it, but it is the fact that it's there and it's used and that's a major part of its present use. Therefore it's a very important source for the first-time home buyer.

Senator **Proxmire**. Thank you very much.

Thank you, Mr. Chairman.

Senator **Lugar**. Mr. Snyder, in the testimony that you've offered, you didn't have an opportunity to elaborate on this because of the constraints of time, but you devoted in your testimony several pages to the general problem of multifamily housing for low-income Americans. Essentially the debate is between the section 8 production idea and one the Administration has presented for vouchers. Other thoughts you have suggested go into the possibility of rehabilitation of existing units.

In the evolution of your testimony, can you give us more of the viewpoint of realtors as to how they look at these options of new production and the costs attendant to that as opposed to rehab, as opposed to vouchers and income supplements, and how you evolved at the reasoning that you presented today?

Mr. **Snyder**. I think, Senator, in regard to the vouchers, we see them perhaps as more of an income assistance program and have some concerns about that. I think, as it relates to the targeting housing assistance to families with incomes below 50 percent of the area median income, we think, in limiting the assistance to the very poor, our membership, particularly the Institute of Real Estate Management, who are professional property managers, believe that while well-intentioned that revision may in fact be too simplistic and perhaps ignores the practical experience which reveals that concentration of families in the 50-percent median income or below results in social and economic problems which increases management and operating costs and I think shorten the life of a project which, of course, is contrary to what we are attempting to do, and that is to extend the lives of the projects.

I think the lower number of families that would occupy section 8 units in the 50- to 80-percent bracket—that is of the area median income—is likely to have an unanticipated impact on the subsidy cost to the Federal Government which would be, again, contrary to our position as it relates to budgetary impact problems.

Senator **Lugar**. The dilemma that this subcommittee has faced for many years is the fact that there are many Americans who are poor and who would qualify for assisted housing and only a very small percentage are being served. In the past, the strategy has been one of producing additional housing, even with the recognition that still only a very small percentage would be served.

The thought has come that in the event income is made available to persons to seek housing that more persons might be served. Although, last year, the subcommittee, the full committee, and in fact the Congress decided that, given the fact there are relatively few people who are eligible being served, perhaps those who were the poorest ought to have the highest priority.

PRIORITY AND SERVICE

The dilemma is one you have presented. That is, in trying to come to some justice as to who was most deserving, administration of a project in which a predominant number of persons have incomes 50 to 80 percent of the median, may have problems as far as management that have not been anticipated. I think, the committee anticipates them. The question is simply the one of: Who ought to get the money? In other words, what ought to be the priority and the service. Furthermore, if we had limited sums of money—and we do—even under the most generous proposals or amendments that I've seen offered by members on both sides of the aisle, there are constraints on what we shall be able to do. So, I don't mean to pose this dilemma to you personally, but I just seize upon your testimony as a way of trying to get this illuminated for the panel this morning. Tomorrow we shall have testimony from many Americans who believe that we ought to be doing a great deal more production, rehab, maybe even income supplementing—and the testimony of this group today has been essentially one of more fiscal conservatism, that if we are to balance the budget or even move toward that, get interest rates down, and you feel there would be a correlation to that, we ought to have some constraints. This is why I delve into this area.

Mr. **Snyder**. May I respond again, Senator?

Senator **Lugar**. Yes.

Mr. **Snyder**. I think that our association is as deeply concerned about housing the people of this country as the U.S. Senate and the House of Representatives. I think our concern as it relates to the voucher is that we think it opens itself up or potentially opens itself up, to an awful lot of abuses.

Certainly, I think a subsidy for those families who fall in the 50- to 80-percent below the area median income bracket is necessary because we do in this country have a responsibility to house our people.

I would say that there are, as you have pointed out, a number of problems that are inherent in this program, but we would certainly support efforts to continue to make efforts to house those people. We do have concerns about the voucher. We think the rent subsidy program as it currently exists may be more successful than the voucher.

Senator **Lugar**. Do any other panel members have thoughts concerning this?

VOUCHER SYSTEM

Mr. **Pryde**. Mr. Chairman, our concern about the voucher system is that you don't have a production system now for multifamily housing. I'm in that area and we perhaps had a production system up until 2 or 3 years ago but we don't have it now in multifamily, and it doesn't look very good for the future in terms of multifamily.

I'm one of those out there that has projects up on the shelf that I could do but I not doing them because I can see the light in the tunnel for multifamily at the present time. And a voucher system, as presently proposed, doesn't do anything to help the production system, and you can have a voucher system and make it work unless you have a production system. And this has been proven so in France where it's probably more extensively used than any other country in Europe.

Senator LUGAR. Mr. Smith.

Mr. SMITH. Mr. Chairman, our industry would certainly strongly feel that the help should go to those who need it most, particularly the elderly and the first-time buyer. Either system would suit us, the voucher or the rent subsidy.

I just wanted one more chance to say that this thing is desperately serious with the housing industry and it's really not fair. We represent 11 percent of the total work force in the country and we're not in a recession; we're in a deep, deep depression. And it would be such a fitting and such an effective way to help the whole economy to return to the Nation's basic commitment of providing adequate housing to those who need it.

Senator LUGAR. On that very positive note, I thank each one of you. Mr. Waldo, do you have a last comment?

Mr. WALDO. I was going to respond to one of Senator Proxmire's questions as to whether or not the FHA's redirection would serve a presently unserved market.

Our position is that the first-time homebuyers in the inner cities are not a neglected market, either by the FHA on subsidized programs, or by the private industry, because these are the people whose loans we both insure—low to moderate income, lower priced housing, lower than average mortgages, are the loans that are insured.

The villain is not the availability of insurance. The villains are high interest costs and the availability of funds.

I think personally that the purpose of putting people in housing should be to keep them there and you don't necessarily do that by extending insurance to a loan that is a submarginal loan based on the economics of the transaction. If we're going to help the first-time homebuyers, we are going to have to do it through some sort of program that helps them get in, either through a subsidy that is going to be an outright grant, or a subsidy that they pay back in time.

Senator LUGAR. Thank you very much, gentlemen.

The Chair would like to call forward now Jeffrey Bragg, Federal Insurance Administrator; and Mr. Lee Thomas, Flood Plain Management.

We are very grateful for our witnesses who appear this morning to offer testimony on the Federal flood and crime insurance and riot reinsurance provisions of the legislation we are considering. It's a pleasure to have as a leadoff witness on this subject, Mr. Jeffrey Bragg, Administrator of the Federal Insurance Administration. Mr. Bragg, would you please offer your testimony.

STATEMENT OF JEFFREY S. BRAGG, FEDERAL INSURANCE ADMINISTRATOR

Mr. BRAGG. Yes, thank you, Senator.

[Complete statement follows:]

STATEMENT BY JEFFREY S. BRAGG, ADMINISTRATOR, FEDERAL INSURANCE ADMINISTRATION, FEDERAL EMERGENCY MANAGEMENT AGENCY

I am Jeffrey S. Bragg, Administrator of the Federal Insurance Administration (FIA), which is one component of the Federal Emergency Management Agency. I am here before the Committee today to address the three insurance programs of the Federal Insurance Administration; namely, the National Flood Insurance Program, the Federal Riot Reinsurance Program, and the Federal Crime Insurance Program, all three of which respond to losses resulting from natural and manmade occurrences. The three programs provide direct benefits and relief to those who have anticipated the possibility of their loss by purchasing policies of insurance.

The largest of the three programs is the National Flood Insurance Program which has nearly 2,000,000 policies in force protecting dwellings and/or contents from loss by flood. The availability of flood insurance in a community is dependent upon the community's adopting and enforcing flood plain management measures. The responsibility within FEMA for administering the flood plain management aspects of the Program is assigned to the Office of State and Local Programs and Support. The Director of this office, Mr. Lee M. Thomas, is here today and will testify on those aspects of the program following my testimony. Individual availability of insurance is conditional upon the insured residing or doing business within one of the 17,157 communities participating in the program as of January 31, 1982. Of these communities, 9,893 are in the Emergency Program, which requires a lesser degree of flood plain management measures by the community, and 7,264 are in the Regular Program which requires more extensive flood plain management measures in accordance with identified base flood elevations in the areas of special flood hazard. Insurance coverage in force nationwide amounts to approximately one hundred billion dollars.

The Federal Riot Reinsurance Program provides reinsurance against the peril of riot and civil commotion to 98 private property insurance companies in nineteen states, a substantial decline from 300 companies insured in the 1980–1981 contract year. Thirty-five billion dollars of Federal Riot Reinsurance is in force.

The Federal Crime Insurance Program provides burglary and robbery insurance to approximately 71,000 residents and businesses in 27 states and the District of Columbia, Puerto Rico and the Virgin Islands, a decline of approximately 10,000 from the previous year. Eligibility for burglary insurance coverage is conditioned upon the insured's compliance with protective requirements designed to deter crime losses. There are approximately 50,000 residential and 21,000 commercial policies in force and insurance in force totals $576,556,000.

Because FEMA's authority to write new insurance policies under these programs expires on September 30, 1982, Congress is faced with the question of whether to extend this authority. This Administration recommends that the current statutory authority for the Federal Riot Reinsurance Program and the Federal Crime Insurance Program be permitted to expire and that the runoff of the business on existing policies be administered under the provisions of the current statute which require no change.

The Federal Riot Reinsurance Program has, fortunately, for the sake of the Nation, not been faced with property loses of the magnitude which were suffered by the private insurance market during the 1960's. Since the program was designed to be self-supporting, premiums have always exceeded losses. To rebuild the National Insurance Development Fund, which has been so depleted by the Federal Crime Insurance Program, Riot Reinsurance premiums were increased for the 1981–1982 contract year. The repeal by the Congress in 1981 of portions of Section 307 of the Housing and Community Development Act of 1978 has resulted in an increase by three states in the number of states in which the reinsurance is offered.

While a major reason cited for the decline in the number of companies purchasing Federal Riot Reinsurance was our increase in the premium rate for the Contract Year 1981–1982, we nevertheless feel that this increase does not controvert evidence that alternative reinsurance coverage is being found readily available in the private sector. In view of the diminishing need for Federal Riot Reinsurance, we recommend that it not be extended beyond September 1982.

The Federal Crime Insurance Program was legislated by Congress after a study made by the Federal Insurance Administration in 1970 indicated that availability and/or affordability problems existed in major urban areas. This program, which in 1970 was grafted onto the 1968 legislation authorizing the Federal Riot Reinsurance Program, has been financed through the National Insurance Development fund into which the premiums from both Federal Riot Reinsurance and Crime Insurance are deposited. Over the nearly eleven years in which the Federal Crime Insurance Program has been in operation, it has paid out in claims roughly $3 for every $1 of premium, and while making affordable crime insurance available as intended by the Congress, it has consumed nearly $138,000,000 of the National Insurance Development Fund. That fund has been built up through the receipt of Federal Riot Reinsurance premiums which have greatly exceeded the amounts of claims payable under that program. No funds have ever been appropriated for the Federal Crime Insurance Program and at the ratio of claims currently anticipated under the Federal Crime Insurance Program, the Program is being continued by calling upon the Program's borrowing authority. Given the relatively small number of insureds in the Program, approximately 75 percent of whom reside in the States of Florida, Pennsylvania, Massachusetts, and New York, and the lack of response to public awareness efforts, we believe that the authority for the writing of new policies under this program, which expires on September 30, 1982, should be permitted to expire. FIA strongly believes that the availability problems of relatively small number of insureds who have felt a need for this program could be addressed at the state level.

The National Flood Insurance Program is by far the largest of the FIA programs and, in terms of its contribution to the goal of flood plain management and long term hazard reduction, we believe that its continuation is clearly in the interests of the Government and that its authority should be extended beyond the September 30, 1982 expiration date which all three programs face. In order to assure better program continuity, we recommend a 2-year rather than a 1-year extension of the NFIP. Many steps have been taken to improve the efficiency of this operation with a more actuarially based premium rate schedule, tighter claims practices and improved overall monitoring of the growing program. We have taken steps to reflect wave height in our premiums on new construction in coastal high hazard V-zones.

On January 1, 1981, rate increases averaging 61 percent were applied to the actuarial rates charged in the Regular Program and the addition of a $20 Expense Constant to the subsidized rates charged in the Regular and Emergency Program resulted in premium increases averaging 22 percent. Moreover, a $50 minimum premium was established which encourages the purchase of three year policies to which only one Expense Constant charge is applied. On October 1, 1981, the subsidized rates were increased for the first time since the beginning of the program by an average of 47 percent. With these rate increases, and increases planned for the future, we are moving toward a goal of bringing the program to an actuarially sound basis by 1988. The FIA is anxious to encourage greater private insurance industry participation in the Flood Insurance Program and looks forward to initiating discussions which would lead to steps which could eventually involve the insurance industry in adminstering some aspects of the NFIP.

This concludes my prepared statement. Mr. Thomas will now address the flood plain management aspects of the National Flood Insurance Program. After completion of his testimony, we will be happy to respond to any questions the Committee may have on our respective areas of responsibility.

[Mr. Bragg subsequently answered some written questions received from Senators D'Amato and Dixon. The questions and answers follow:]

QUESTIONS FROM SENATOR ALAN J. DIXON FOR ADMINISTRATOR JEFFREY BRAGG

RIOT REINSURANCE

Question 1: In your testimony, you say that the riot reinsurance program is no longer needed because reinsurance is readily available in the private market. To what evidence of private availability are you referring?

Answer: During January 1982, FIA inquired of all companies who purchased Federal riot reinsurance coverage in previous years, as well as this year, concerning private reinsurance availability. Approximately half of the companies responded and 73% reported that they had found riot reinsurance available in the private market at a cost considered comparable and in some instances less expensive than the Federal riot reinsurance. Although not all the companies responded, we believe that the letters we received present substantial evidence that reinsurance availability in the private sector has increased.

Question 2: To what degree do you think that the high drop-off in Federal riot reinsurance policies is attributable to the 1000% increase in premiums?

Answer: The increase in rates from 0.025% to 0.25% of the insurer's direct earned premiums on reinsured lines is a major reason for the drop-off in the number of companies purchasing riot reinsurance. FEMA believes, however, that this increase does not contravert evidence that alternative reinsurance coverage is being found readily available in the private sector at a cost which the companies apparently found to be acceptable.

Question 3: How do federal rates compare to private market rates?

Answer: In the private sector, coverage against riot losses is not sold as a separate line of reinsurance but rather as a part of an overall reinsurance coverage. Therefore, the disparity in the method by which coverage is obtained in the Federal program, as contrasted to the private market, make it impossible to compare rates.

However, it is clear that adequate reinsurance is readily available in the private market at reasonable rates. This availability in the private sector explains the departure from the Federal program this year of more than two-thirds of the companies previously participating. This withdrawal has resulted in a reduction in coverage in force in the Federal program of 88% from the last contract year, even though the number of participating states increased. However, survey results do show that 23 companies estimated that the rates now charged even after FIA rate increases, are comparable to the private cost and 15 found the private sector rates to be cheaper. Finally, it should be noted that the Federal program was never designed to compete with the private market but to fill a void in the aftermath of the riots of the late sixties. That void no longer exists.

Question 4: Is the private market currently capable of handling the entire riot reinsurance business should the Federal Riot Reinsurance Program be eliminated?

Answer: FEMA believes, through its survey mentioned above and discussions with industry officials, including representatives of companies providing reinsurance, that the private reinsurance market is capable of handling the entire riot reinsurance business.

Question 5: You may remember that on December 2, 1981, the Secretary of Housing and Urban Development suggested that OMB's proposals for tenants' rents, which were not significantly different from those presently being pursued by the Administration might lead to "rent strikes, massive evictions, project defaults, higher outlays,...and political and social unrest..." If the Secretary's assessment is correct, do you think that the private market would then be capable of handling the entire riot reinsurance business? If yes, at what price?

Answer: I am not in a position to comment on the basis for such a "suggestion" by the Secretary. However, I believe that the current private reinsurance industry has the capability to provide reinsurance against the possibility of riots and civil commotion. This is based in large part on assertions by the private industry. However, there have been some actual riot situations which have tested those assertions. For example, recent riot losses in Florida were absorbed by the private reinsurance sector with no participation by the Federal Riot Reinsurance Program. On all the evidence available, insurance companies are currently able to obtain reinsurance with no difficulty at rates which have elicited no complaints. Based upon all those facts, I do not see that the continuation of a Federal program which merely duplicates and competes for coverage available in the private sector is justified.

FEDERAL CRIME INSURANCE PROGRAM

Question 1: In your testimony, you suggest that the Crime Insurance Program be ended because of the relatively small number of insureds in the program and the lack of response to public awareness efforts. How much has been expended by the FIA to make the public aware of the existence of the program?

Answer: In 1978, FIA began a pilot project to market crime insurance through community based organizations in five selected cities. This project was completed in 1979 at a cost of $443 thousand and resulted in no significant increase in policies in force.

In view of the "critical crime insurance availability problem" which forms the basis for the introduction of the Federal Crime Insurance Program into a state, the demand for the Federal policies should be such that there would be relatively little need to promote the purchase of the policies once the public has been adequately informed of its availability in the State. Given the very substantial subsidy the policyholders receive in the form of "affordable" premiums, I do not favor further expenditures of taxpayer funds to market the policies. Moreover, our experience demonstrates that insurance agents and brokers are the key to the process of selling. We attempted to publicize the Program in the project mentioned above and have concluded that greater public awareness does not guarantee the purchase of a significantly increased number of policies.

Question 2: As you know, the program was started because of a concern about the lack of available and affordable crime insurance in our cities. Since that time, the crime rates in our major cities have remained about the same while at the same time the crime rates in many of our smaller cities have skyrocketed.

Do these facts justify a need to continue the program? Please explain.

Answer: FIA does not believe that the crime experience in smaller cities justifies continuation of the Federal Crime Insurance Program. In the three states with a policy count exceeding 3,000, 93% of the policies are in one major city in each state. In addition, these three cities, New York, Philadelphia, and Miami, comprise 66% of the total policies nationwide.

The demand for crime insurance as well as the sale of crime insurance is most likely to occur in areas where crime exposure makes potential customers seek the coverage. The fact that in all but three states, less than 3,000 Federal Crime Insurance policies have been purchased in any one state indicates that there is a viable private crime insurance market. Additionally, there are 23 states which have not chosen to participate at all in the Crime Program. While New York State, with 40,000 policies in force, has the largest participation in the program, that number still does not demonstrate a need for a Federal Program and, given the population of New York State, the 40,000 does not represent a high proportion of the insured public of that State.

Question 3: In 1978, the FIA issued a report entitled "Insurance Crisis in Urban America". That report stated that "insurance redlining today denies many urban property owners access to a voluntary insurance market". Additionally, the report states that the effect of redlining is that "many property owners are denied access to insurance at affordable prices."

Is there any comparative quantitative evidence to suggest that the availability and affordability problems no longer exist?

Answer: While FIA has no recent information to substantiate or alter the conclusions stated in the 1978 FIA report, "Insurance Crisis in Urban America", it should be noted that the Report was addressing the subject of fire insurance and FAIR Plans rather than crime insurance. The fact that in the thirty jurisdictions in which Federal Crime Insurance is available only 70,000 policies are in force strongly suggests that the actuarial rates charged by private companies are in fact substantially affordable. While some persons, especially in the four states in which most of the policies are written, experience difficulty in obtaining insurance, insurance is generally available.

Question 4: At the same time that you are proposing the elimination of federal crime insurance, the President is proposing the creation of urban enterprise zones.

Do you think that the concept of urban enterprise zones can work without the existence of a crime insurance program? Please explain.

Answer: Although insurance is an important aspect of this concept, a Federal Crime Insurance Program is not necessary to provide that insurance.

QUESTIONS SUBMITTED BY SENATOR D'AMATO TO FEMA

The Federal Crime Insurance Program (FCIP) was started in the early 70's because people in high crime areas were not able to get insurance at affordable rates. Now, the Federal Insurance Agency has proposed terminating the FCIP.

1. Question:

If there is no FCIP how would the insurance be provided, and who will pay for it?

Answer:

Crime Insurance is currently being written by the private insurance industry in all fifty States and other jurisdictions. To the extent that there are potential insureds whose exposure to crime losses makes the cost of insuring such individuals and businesses so high that they are unable to find an insurer or are unable to pay the premium required to obtain coverage, it is possible that insurance may be made available through mechanisms developed at the State level. For example, the States of Michigan and New Jersey have had statutory crime insurance programs since 1971 which have apparently met the needs of their citizens. Other states have developed their own mechanisms for dealing with this issue.

2. Follow up Question:

How could an insurance company afford to offer crime insurance at affordable rates if the premiums are not subsidized?

Answer:

A private insurance company can provide an insurance market only by offering insurance at an actuarial premium, and we would not suggest that any private company do otherwise. The fact that in the thirty jurisdictions in which Federal Crime Insurance is available, only 70,000 policies are in force, and that 23 states do not participate in the FCIP, strongly suggests that the actuarial rates charged by private companies are in fact substantially "affordable". If a State concludes that the interests of its citizens require that insurance coverage be made available at rates that are not actuarially sound, a State may wish to sponsor a special program which would employ a subsidy mechanism. In any program, however, strict protective device requirements should be established to deter crime losses and reduce to the minimum any need for insurance coverage outside of the voluntary property insurance mechanism.

3. Follow-Up Question:

What evidence do you have that insurance companies will provide insurance in high crime areas?

Answer:

Crime insurance is now offered in all 50 States. The fact that in all but four States, not more than 2,700 Federal Crime Insurance policies have been purchased in any one State, indicates that there is a viable private crime insurance market and that the market exists even in many "high crime areas". While New York State, with 40,000 policies in force, has the largest participation in the Program, that number still does not demonstrate a need for a Federal Program and, given the population of New York State, the 40,000 does not represent a high proportion of the insured public of that State.

Question on Promotional Methods of the Federal Crime Insurance Program (FCIP)

Two GAO audits of the Federal Crime Insurance Program indicate that people in eligible areas did not know the Program was available and had they known, they would have bought the insurance.

4. Question:

What marketing and promotional strategies are used by the Federal Crime Insurance Program?

Answer:

When the Federal Crime Insurance Program enters a new State, a press release is developed and circulated by FEMA's Office of Public Affairs to the news media. FIA staff visits the Insurance Commissioner's, the Mayors' and Governor's offices, as well as other local officials. An information package of material on the program is mailed to agents and brokers throughout the State. For example, 74,000 such agents and brokers were reached when the Program was introduced into California.

5. Follow-up Question:

What improvements could be made to have more people know about the Federal Crime Insurance?

Answer:

In view of the "critical crime insurance availability problem" which formed the original basis for the introduction of the Federal Crime Insurance Program, the demand for the Federal policies should be such that there would be relatively little need to promote the purchase of the policies once the public and, more importantly, the agents have been informed of its availability. Given the very substantial subsidy the policyholders receive in the form of "affordable" premiums, I do not favor further expenditures of taxpayers funds to market the policies. Moreover, our experience demonstrates that insurance agents and brokers are the key to the process of selling. FIA has attempted to publicize the Program in the past and has concluded that greater public awareness does not guarantee the purchase of a significantly increased number of policies. I believe that the Federal Crime Insurance Program should be an insurer of last resort. By keeping insurance agents and brokers aware of the Program through workshops, we are making the availability of the insurance known to the most effective marketing source, yet not competing with a business that should be conducted in the private sector.

(Cont)

Question on Promotional Methods of the Federal Crime Insurance Program (FCIP)

6. Question:

What efforts have been made to establish linkages with other programs -- Federal, state, local and commercially - sponsored - - which would either augment or support the benefits provided by the Federal Crime Insurance Program?

Answer

Our staff has had a working arrangement with the Law Enforcement Assistance Administration (LEAA) in several of their crime prevention projects. We also have direct contact with several police departments and have communicated with them upon introducing the Program into a new state. Reduction of opportunities for crime through greater security consciousness has great priority in the administration of the Program.

7. Follow-Up Question:

If the Federal Crime Insurance Program is continued, would you be willing to pursue this further?

Answer:

If Congress determines that the Program should be continued and provides the necessary appropriations, FEMA/FIA will carry out the Congressional mandate and administer the Program as efficiently as possible. We will cooperate with other government agencies in promoting crime reduction and provide them with Program information. But for the reasons noted above, I do not favor using taxpayers funds to aggressively market a subsidized insurance program in a way which would compete with the private insurance sector, particularly since the Program was never intended to be other than an insurer of last resort.

Question on Cost of Premiums Remaining the Same Since 1973

Federal Crime Insurance claims that the Program spends almost 3 dollars in benefits for every one dollar in premiums. While the Program by its nature will always suffer because of adverse selection, premiums could clearly be reasonably raised to reduce this ratio significantly without altering the large scale availability and affordability.

8. Question:

For what reason has the premium structure of the Federal Crime Insurance Program remained unchanged since 1973, given the increasing incidence of theft and inflation?

Answer:

That decision was made by previous administrations apparently on the theory that they should keep the rate low to encourage the purchase of the policies.

9. Follow-Up Question:

If the Federal Crime Insurance Program is maintained, what suggestions do you have to make the Program more self-sustaining?

Answer:

This administration has already acted to make the Program more self-sustaining. As noted by the GAO in its report to Congress dated March 15, 1982, within the last year, FIA has proposed several changes to the Program. A premium increase has been announced. Underwriting and claims adjusting practices have been revised. These changes are designed to reduce program losses and potential program abuses.

FIA has made recent changes to the Crime Insurance Program's underwriting practices. Before April 1981, limited or no consideration was given a policyholder's previous losses. In addition, because of an insufficient number of business classes, approximately one-third of the commercial policyholders were in an undefined business class. FIA has reclassified these policies into separate business classes.

FIA has completed a loss history study to determine whether additional protective devices were needed. Out of the 94 revised and new commercial classifications, only 7 types of businesses do not require alarm protection.

With the premium increase, reclassification of businesses, updating and new requirements for alarm protection and closely controlled claim payments, we should reduce the cost and subsidy of the Program.

Question on Rate Increases:

The limits of coverage available through the Program have not increased since its inception.

10. Question:

Considering inflation over the past decade, would reasonable increases in the limits of coverage be beneficial to the Program?

Answer:

We have analyzed the amount of coverage being purchased and do not believe that increases in the limits of coverage would be of benefit to most insureds, or for the Program itself.

11. Follow-up Question:

To what extent has the Federal Insurance Agency examined this subject?

Answer:

The average commercial policy provides $13,000 of coverage and the average residential coverage is $7,000. Both figures are below our current policy limits ($10,000 residential and $15,000 commercial). I also believe it desirable to encourage the purchase of additional limits of coverage in the private insurance market in cases where insurance in excess of the Federal limits is needed. In view of our current information and a lack of demand for higher coverage, we have seen no need to increase limits.

Question on Cost Effective Changes

Private industry has gone to telephone adjusting for most losses under $5,000 and has found this to be a cost effective way to reduce administrative costs.

12. Question:

If the Federal Crime Insurance Program is continued, would you consider using this cost effective alternative?

Answer:

My staff has met with two large private insurance carriers to review the potential cost savings in light of the experience these carriers have had with telephone adjusting. We have also analyzed our losses and initiated a cost proposal from our servicing contractor to study how this system would work. We will make a final determination after the Congress has determined the future of the Program. If the evidence shows that there would be actual cost savings and adequate safeguards against possible fraud and abuse, I would favor trying the approach.

The Federal Crime Insurance Program allows property replacement which is proven to hold cost below cash reimbursement.

13. Question:

Why hasn't the Federal Insurance Agency (FIA) chosen to use this cption?

Answer:

My staff has met with representatives of the private insurance industry and developed a list of suppliers now being used by various insurance companies. This information has been turned over to our servicing contractor and, whenever it is advantageous, we are, in fact, replacing stolen articles rather than making a cash payment to the insured.

Questions on FCIP Practices During the Past Two Years?

14. Question:

To what do you attribute the decrease in policies over the past year? Please provide facts supporting your conclusions. What has the Federal Insurance Agency (FIA) done to reverse the decline in policies?

Answers:

Effective July 1, 1980, the FIA changed its residential policy coverage, placing a $500 limit on coverage for items such as jewelry, gold, silver, furs and fine arts. As of June 30, 1980, there were 63,678 residential policyholders, and fifteen months later the policy count was reduced to 51,472.

We have taken no steps to reverse this decline in residential policies. One of the primary reasons for implementing the revision in coverage was our experience which indicated that the Federal Crime Insurance Program was, in effect, serving as an unscheduled insurer for jewelry and the like, with the premium charged not being commensurate with the risk. Moreover, in our opinion, it was not the intent of Congress for the Federal Crime Insurance Program to perform such a function.

As stated above, we do not believe that the response to the creation of the Federal Crime Insurance Program over the past ten years, as represented by a total number of only 70,000 policies, warranted further Federal expenditures to create a broader market by competing with the private insurance sector. In fact, we consider it highly significant that despite a heavy subsidy, and as previously reported, adequate efforts to promote the Program, only 70,000 policies are in force. While the 1970 finding of a critical affordability and availability problem may have had some validity 12 years ago, current experience indicates that problem is not one which requires a Federal solution.

15. Question:

Only 28 states and jurisdictions currently participate in the FCIP. How many additional states have indicated their desire to join the Program? Why hasn't the Federal Insurance Agency (FIA) permitted them to join?

Answer:

Currently there are 27 States, the District of Columbia, Puerto Rico and the Virgin Islands participating in the FCIP. The State of Mississippi through the Insurance Department has requested that the State be certified to participate in the Program. This request was received in January 1982. We need a lead time of 90 days to bring a new State into the Program and based on the administration's decision to request Congress to terminate the program in September 1982, we indicated to the Insurance Commissioner, George Dole, that it would be an injustice to offer the Federal Crime Insurance Program to the citizens of Mississippi until we receive some indication from the Congress on the future of the program. If the Federal Act is extended, FIA will act promptly to make Federal Crime Insurance available in the State of Mississippi or any other state in which introduction of the Program is warranted under the authority of the Act.

Questions on FCIP Practices During the Past Two Years (cont)

16. Question: (In 4 parts) - (Part 1)

What studies has the FIA done to determine why the policies are concentrated primarily in New York, Massachusetts, Pennsylvania and Florida?

Answer:

We have done no studies in the above mentioned States to determine why there is a high concentration of FCIP policies in force in these particular States. However, it is our opinion that a combination of factors such as the degree of availability of private insurance, the perception of a crime risk and sales activity by insurance agents and brokers have an effect upon the purchasers of crime insurance.

17. Question: (Part 2)

What studies have been done to determine why people do or do not buy Federal Crime Insurance?

Answer:

No studies have been done to determine why people do or do not buy Federal Crime Insurance. The Program was never proposed to be in competition with the voluntary insurance market but rather a program of last resort. Therefore, we do not believe that conducting studies to determine why people do or do not buy a subsidized product would be cost effective.

18. Question: (Part 3)

What is the geographical distribution of policies within New York?

Answer:

In-force Policies - 2/28/82

	Residential	Commercial
Bronx	1,424	1,408
Kings	10,507	3,974
New York	9,517	3,238
Queens	3,541	1,675
Richmond	407	253

19. Question: (Part 4)

What are the sociological and economic characteristics of the geographic areas with concentrations of Federal Crime Insurance policies?

Answer:

We do not have any mechanism for compiling such information.

Question on Affordability of Crime Insurance for Small Businesses

It is essential that small businesses and especially new businesses in high crime areas have crime insurance. In the first year of a new business, a robbery could wipe him out.

20. Question:

How can a small business get insurance in a high crime area at affordable rates if no insurance company can afford to offer that insurance?

Answer:

Crime Insurance is written by the private insurance industry in all fifty States. To the extent that there are potential insureds whose exposure to crime losses make the cost of insuring such individuals and businesses so high that they are either unable to find an insurer or are unable to pay the premium required to obtain coverage, it is possible that insurance may be made available through mechanisms developed at the State level. For example, the States of Michigan and New Jersey have had statutory crime insurance programs since 1971 which have apparently met the needs of their citizens and other States have developed their own mechanisms for dealing with this issue. However, strict protective device requirements should be established to deter crime losses and reduce to the minimum any need for insurance coverage outside of the voluntary property insurance mechanism.

One of the beauties of the Federal Crime Insurance Program is that it does not cancel a policy after a business is robbed the first or even the second time.

21. Question:

What is the practice of insurance companies after a robbery? Are premiums raised so that they are no longer affordable? Are policies cancelled?

Answer:

The Federal Insurance Administration has no authority over the practice of insurance companies. This authority rests with the States through their respective Insurance Departments. Practices vary between companies. There is no single industry standard that we are aware of and in some instances state laws may have an impact upon the practices of companies in particular states.

Senator LUGAR. Thank you very much, Mr. Bragg.
Mr. Thomas.

STATEMENT OF LEE M. THOMAS, FLOOD PLAIN MANAGEMENT, FEDERAL EMERGENCY MANAGEMENT AGENCY

Mr. THOMAS. Thank you, Mr. Chairman. My statement is also available to be entered into the record and I will summarize that.

[Complete statement follows:]

STATEMENT BY LEE M. THOMAS, ASSOCIATE DIRECTOR, STATE AND LOCAL PROGRAMS AND SUPPORT, FEDERAL EMERGENCY MANAGEMENT AGENCY

The National Flood Insurance Program is administered by two organizational entities within the Federal Emergency Management Agency: The Office of State and Local Programs and Support, which I head as Associate Director; and, the Federal Insurance Administration. My office is responsible for the flood hazard mitigation Activities of the program, which I will address in my presentation to you today. The Federal Insurance Administration is responsible for the insurance aspects of the program which have been described to you by Mr. Jeffrey S. Bragg, the Federal Insurance Administrator.

I would like first to provide you with a brief description of the National Flood Insurance Program and its goals and then I will explain how the flood hazard mitigation activities carried out by FEMA aid in achieving those goals.

The National Flood Insurance Program (NFIP) is a self-help program designed to reduce the high costs of flood disaster assistance. Established by Congress in 1968 under the National Flood Insurance Act, the program was originally administered by the Department of Housing and Urban Development. Broadened and modified since then, it is now administered by the Federal Emergency Management Agency (FEMA), with functional responsibilities delegated within FEMA as I have described to you.

Congress created the program to address the problem of increasing annual flood losses. For decades the national response to flood disasters was generally limited to building flood control works (dams, levees, seawalls, etc.) and providing disaster relief to flood victims. To compound the problem, the public could not buy flood coverage from insurance companies, and building techniques to reduce flood damage to new construction were often overlooked. In the face of mounting annual flood losses, Congress created the program to mitigate future damage and provide insurance against property losses which do occur.

The program works on the basis of an agreement between the Federal Government and those flood-prone communities that choose to participate in the program. The community agrees to adopt and enforce the minimum standards required by FEMA for mitigation of flood losses. The detail of flood risk information published by FEMA determines the extent of regulation by a community of its flood hazards. In return for community flood plain management, the Federal Government agrees to make flood insurance available to individual property owners as a financial protection against flood damage.

The program must have community participation to work. Without community oversight of building activities in the flood plains, the best efforts of some to reduce flood losses could be undermined or destroyed by the careless building of others. Unless the community as a whole practices adequate flood hazard mitigation, the potential for loss cannot be lowered sufficiently to reduce disaster assistance costs. The insurance rates for new construction in a community depend on how safe the structure is from the estimated flood risk.

This agreement by participating communities to practice adequate flood plain management to mitigate future losses is the cornerstone to the program. Congress did not intend to subsidize indefinitely the expense of the program. If the program is to become financially self-supporting as Congress intended, wise flood plain management must be achieved in all participating flood-prone communities.

FEMA and the States have important roles in achieving the goal of the NFIP to reduce flood losses. FEMA is required by law to identify all flood hazard areas and notify the affected communities, alerting them to the degree of hazard. FEMA also provides technical assistance and funding to States and local governments for flood hazard mitigation purposes. In the event of a Presidentially-declared flood disaster, FEMA provides disaster assistance and aids in recovery efforts to communities participating in the program. FEMA is also required by law to develop criteria or standards to encourage States and local governments to adopt adequate measures for flood hazard mitigation.

The Office of State and Local Programs and Support is responsible for several activities in administering the National Flood Insurance Act to achieve the goals set forth by Congress. These activities include: (1) identifying and studying flood risk areas; (2) establishing and maintaining minimum standards for community flood plain management programs; (3) acquiring severely or repeatedly flood damaged properties; and, (4) providing financial assistance to States to develop their capabilities in flood hazard mitigation activities.

Section 1360 of the Act requires FEMA "to identify and publish information with respect to all flood plain areas, including coastal areas located in the United States, which have special flood hazards," and to "establish flood-risk zones in all such areas, and make estimates with respect to the rates of probable flood-caused loss for various flood-risk zones for each of these areas." The 1968 Act set a five year deadline for identification of all flood plain areas and a fifteen year deadline for establishing flood-risk zones.

We have identified flood hazards in approximately 20,000 communities and published maps for these communities. Thus, we have successfully completed the flood hazard identification requirement of the Act. Of this total number, as of January 31, 1982, 17,157 communities with identified flood hazards have chosen to participate in the program. 9,893 of those communities participate in the emergency phase of the program. 7,264 of the total number of communities participating in the program are in the regular phase. For most communities, regular program participation means that base flood elevations have been determined for the identified flood hazard areas in these communities. Also, in many of these communities floodway data has been developed.

With the 1983 deadline approaching for establishing flood-risk zones in the communities which have not had detailed flood studies conducted, it is clear we will not meet that deadline. While we anticipate we will be able to convert many communities to the regular phase of the program without detailed analysis of their flood hazards because the flood risks are considered minimal, at least 4,500 new detailed studies must be initiated in addition to over 3,000 presently underway.

Thus, with several thousand detailed studies remaining, our new studies effort cannot be concluded before 1987. This deadline, of course, assumes we have sufficient funds for these remaining studies.

The primary reason we have not been able to accelerate flood studies is lack of funding. We have $32,356,000 for flood studies for fiscal year 1982. For fiscal year 1983, we have requested $45,582,000 for flood studies. We are committing these limited funds to the following efforts as priorities: studying only areas which our Regional Offices, in cooperation with the States, have identified as possessing high or rapid development; restudying rapidly growing high risk areas such as Dade County, Florida and Orleans and Jefferson Parish, Louisiana; and, finalizing coastal community studies including identification of the wave height hazard.

We have requested the Congress to extend the 1983 deadline for completing flooding studies to 1987. However, the successful completion of the new studies effort will be dependent on the availability of adequate funds. We are making every effort to economize and maintain the annual average new study cost of $88,000. We are intensifying our search for data developed by others which can be utilized in the production of our flood studies. We view the study effort as essential to the long-term success of the program. While we are making every effort to keep the lid on costs and explore some means of defraying costs, we will need adequate funding from the Congress to provide sufficient flood risk data to the communities remaining to be studied.

I have outlined for you the flood risk data needs of the nation's flood-prone communities, which FEMA is attempting to meet. I would now like to bring your attention to two other program initiatives FEMA has undertaken to reduce flood risks.

One noteworthy and cost efficient effort is the section 1362 acquisition project. Section 1362 of the National Flood Insurance Act of 1968 authorizes the Director of the Federal Emergency Management Agency to negotiate for the purchase of certain flood damaged, insured, properties for subsequent transfer to State or local agencies. Land acquired this way is placed in permanent open space use, free of vulnerability to future flood damage. The purpose of the section is, therefore, to reduce the costs, to the Flood Insurance Program and Disaster Relief Program, of responding to repetitive flood losses and to assist insureds in relocating out of the flood plain, thus, breaking the cycle of continuing flooding and repair of insured structures. During the two years of property purchases under this section, 163 properties in sixteen communities were acquired at a cost of just over $9.0 million.

Concerning the cost effectiveness of the acquisition program, our research has determined that the average after insurance cost for acquiring eligible properties on a nationwide basis, in 1981 dollars, will be $22,000. The subsidy portion on insurance claims, is over $23,000 in 1981 dollars. This potential for savings does not include those damages covered by premiums as well as other costs to society such as death, reduced productivity, business interruption, and the impact of unnecessarily rebuilding existing housing. Evaluation of the initial two years of the program confirms this achievement of cost savings.

This year, FEMA will concentrate on selecting projects which best meet the selection factors in our regulations. For Fiscal Year 1983, $4.78 million is being requested to continue the 1362 program.

Another initiative designed to aid in achieving the goals of the program is the flood hazard mitigation oriented state assistance program. Successful floodplain management efforts require a cooperative intergovernmental approach, with States forming the key link. Recognizing this, FEMA provides support to each State to encourage the exercise of their floodplain management responsibilities. Such support includes annual financial assistance; technical assistance, as needed; and the sharing of expertise, policies, and experiences at an annual Conference for the States.

The State Assistance Program is designed to develop or improve:

State plans to perform intergovernmental floodplain management coordination activities and to develop formal Statewide floodplain management programs;

Statewide information networks that promote an increased understanding of floodplain management concepts and techniques; and

State programs to assist local governmental officials in the mechanics of implementing and administering floodplain management programs thereby decreasing the need for Federal involvement.

Fiscal Year 1981 State Assistance Program funding supported the following noteworthy activities underway during fiscal year 1982:

The delivery of technical services to local communities in 26 States.

The development of new or improved floodplain management legislation in 15 States.

The preparation of assessment reports, inventories or mitigation plans in 26 States.

The publication of guidebooks, manuals or brochures in 19 States.

The development of public awareness campaigns or materials in 19 States.

The establishment of flood hazard data repositories in 23 States.

The instruction of local or State officials on floodplain management in 20 States.

The delivery of information packages on the NFIP in 13 States.

The development of technical instruments, such as model ordinances, in 13 States.

The Fiscal Year 1982 funding will further these and similar activities in additional States.

In fiscal year 1983, FEMA proposes to initiate 54 cooperative agreements on a 75 percent Federal 25 percent State cost-sharing basis with the 50 States, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands. Continuing objectives for this assistance program include:

Strengthened State enabling legislation;

Development of adequate standards and criteria for local regulations;

Improvement of State and local floodplain regulations;

Centralized and responsive information services and data sources in each State;

Improved accessibility of the public to information about flood hazards at the State and local level;

Substantial increase nationwide in the number of competent individuals at all levels of governments, who are knowledgeable about flood hazard mitigation (particularly at the level, which is close to the problem);

Substantial increase in technical assistance to communities to maximize the use of successful flood hazard mitigation strategies and methods;

Sufficient monitoring and evaluation to assure community compliance with State and local regulations.

As we meet these objectives, we will move closer to shifting greater responsibility to the States for meeting the challenges created in wisely using the nation's flood plains and protecting our citizens against flood damage.

We know that floods are the most devastating recurring disaster to hit our citizens year after year. The flood hazard mitigation activities associated with the National Flood Insurance Program and administered by FEMA are designed to help these people avoid this devastation caused by floods and, when it cannot be avoided, to recover as quickly as possible without economic ruin.

Senator LUGAR. Thank you very much, Mr. Thomas.

Mr. Thomas, obviously, your testimony brings to mind personal experiences of mine going through Fort Wayne recently. Obviously you have been active there and I congratulate you and your agency in working with others and coordinating the response. The Fort Wayne situation I take as a point of departure because obviously the flood management plan has been in operation and there's been much discussion over the years.

In the aftermath of that difficulty, describe what kind of counsel and advice you will offer to local and State or Federal authorities as to how things should proceed. In other words, there are, mercifully on this occasion, hundreds of families left untouched. There are other properties that were flooded and some of them have indeed been scheduled for demolishing sometime ago in reference to this general scheme. How do these things work over the years and how do you try to make less vulnerable that which is there and minimize the expenses of the program in rehabilitating people when floods come?

MITIGATION ASSISTANCE TEAM

Mr. THOMAS. I think that is a good case in point because in Fort Wayne we are currently in the middle of a disaster recovery effort and we try to emphasize not only the assistance for recovery but also what we can do to mitigate further occurrence of such a situation. We have initiated a 12-member mitigation assistance team representing 12 different Federal agencies that have expertise, ranging from our agency to the Corps of Engineers, particularly in the area of flooding and flood control, to work with the city of Fort Wayne, the local jurisdiction, as well as the State of Indiana, as we develop specific measures that can be taken to try and avert future flooding in the nature of the flooding that occurred there.

You've got a significant problem in Fort Wayne. It's been under study for several years in depth. What we find is when there is an actual occurrence of a flood such as the current disaster the community particularly becomes aware of the fact that measures have got to be taken and are often, as we are finding in Fort Wayne I think, willing to take a number of steps to try to assure that mitigation measures are taken.

It's a unique opportunity for some difficult decisions to be made in flood plain management.

Senator LUGAR. Beyond your resources, do you then coordinate activities with the Corps of Army Engineers or other persons in Government who have other moneys? For example, to use the parochial problem of Fort Wayne again, it's been suggested that a very large ditch may be needed through much of Allen County to bring the rivers around the junction where they flood. That costs millions of dollars and the program that you're administering does not contemplate those sort of expenditures. But what sort of coordination procedures do you have with other agencies of Government?

Mr. THOMAS. We have a close coordination effort with the other agencies. The Corps of Engineers is an example. So that within 30 days after the disaster we have developed with the State and locals a specific mitigation plan for that community that includes both structural and nonstructural flood plain management recommendations. The Corps of Engineers participates with us, as do any number of other agencies and the local jurisdiction. We have met with the committee established by the mayor of Fort Wayne. We have a team on the site that's been there since the disaster occurred proceeding with exactly the kind of thing you're talking about.

PREMIUM REVENUE VERSUS PAYOUTS

Senator **Lugar**. Last year, Mr. Bragg, in discussing all of these insurance programs, the committee took a look at a premium revenue as opposed to payouts. While not terminating two programs that you have suggested for termination today, the thought was that perhaps they might become more self-supporting in the process. I'm intrigued by your testimony that, for example, in the Federal crime insurance program many fewer companies are involved. Is this because the premiums went up or is it because, as you have suggested, other alternatives are available? What was the net effect of the changes in premiums per se?

Mr. **Bragg**. With which program?

Senator **Lugar**. The crime insurance program.

Mr. **Bragg**. We have not instituted rate increases for the crime insurance program yet.

Senator **Lugar**. So that stayed as it was. Why the decline in the other one?

Mr. **Bragg**. We think the major reason for the decline in the 10,000 policyholders is because we put a limitation on coverage for luxury items. Up until June 1980, luxury items were covered to the full extent of the policy. We put a $500 limitation on them and we believe many people were purchasing crime insurance simply to get the insurance for the luxury items. Changing the coverage reduced dramatically the number of policyholders.

Senator **Lugar**. So you believe some of the policyholders were persons of some wealth or had luxury items and were availing themselves of the Federal crime insurance program and——

Mr. **Bragg**. At heavily subsidized rates, Mr. Chairman.

Senator **Lugar**. Which you have eliminated now?

Mr. **Bragg**. We think we have eliminated at least that problem.

Senator **Lugar**. Now you point out with regard to the crime insurance the limited scope of that and the even more limited scope of the riot insurance. Clearly, there are Members of the House and the Senate from the particular States that are involved. I can recall a very exciting conference last year on these situations. One of the reasons we still have programs, I suspect, comes down to that point. What kind of backup do you have—obviously, these are summary figures, but as you take a look at the actuarial subsidies that are involved, is there any way to illustrate essentially the kind of subsidy that is going to very specific areas by the maintenance of this type of thing? It becomes almost the same sort of argument, I suppose, that some would make against a large Federal water project or a project for a waterway through a State, a huge grant of money in a specific sense, although I don't believe it's been graphically portrayed that way before.

Can you offer us some thoughts about that?

Mr. **Bragg**. Mr. Chairman, let me just say generally that the program was subsidized last year to the extent of $32 million. I can tell you what the subsidy was by State in terms of the written premium in that State versus the amount of money that was paid out.

Senator **Lugar**. Obviously, there are very few States.

Mr. **Bragg**. It's dramatic, Mr. Chairman, and over the history of the program, we are talking about a written premium income of about $66 million and losses totaling over $174 million, and we will submit for the committee a breakdown by State.

Senator **Lugar**. Have almost all of those losses occurred in the State of New York?

Mr. **Bragg**. New York has about 58 percent of the policies. The premium income in the program is $38 million and the losses were more than $125 million for New York alone, and it's equally dramatic for other States.

Senator **Lugar**. I simply raise the question—and I appreciate the response—to make a point. I think perhaps in the past we have not focused as a body in the Senate upon the very specific nature of this problem and perhaps we will be able to do so. I support at least making a case as to whether we continue or stop this particular form of insurance.

Mr. **Bragg**. Well, if you will just allow me to continue, Mr. Chairman, there are 23 States, for example, that do not participate in the program at all and they potentially subsidize those States that do, and with 77 percent of the policies in the program focused in only 3 States, certainly it's our recommendation that this program is not national in its scope at all and that mechanisms exist in the States and with the private insurers to solve these problems where they do exist as opposed to trying to do it on a national level.

Senator **Lugar**. As I understand, the authority of the FEMA to write new insurance policies expires September 30, 1982. Is that true of all three insurance programs?

Mr. **Bragg**. Yes, sir.

Senator **Lugar**. All three expire on that date?

Mr. **Bragg**. Yes, sir.

Senator **Lugar**. Now what if for some reason the Congress has been preoccupied with all sorts of other things and we come to September 30 and nothing has happened? What do you do in your capacity over there?

Mr. **Bragg**. I suppose I look for a job, Mr. Chairman.

Senator **Lugar**. Aside from that rather traumatic——

Mr. **Bragg**. If Congress does not extend the authority to write these programs, we will not be permitted to do that, and we would remain in business long enough to pay the claims that may incur for the period that coverage was allowed. That would be approximately a year in both the crime and flood insurance programs.

Senator **Lugar**. You would have a staff of people paying claims and winding down the administration, but it requires affirmative action on the part of the Congress in order for any of the three to continue?

Mr. **Bragg**. Yes, sir; that action would take place in the form of authorization or approval of the budget submitted by the administration, and as we have recommended all that is contained in that budget submission is continuation of the flood insurance program.

Senator **Lugar**. I understand. I simply am trying to isolate those things which are truly emergencies. We have in this legislation a whole package of a great number of things and attempting to reach agreement on all of them is sometimes difficult. We are trying to at least isolate in this testimony those things that are emergencies that we can highlight for the eyes of members, what we must address or what the consequences would be upon failure to do that.

I thank both of you for your testimony today.

[The following table was received for the record:]

FEDERAL CRIME INSURANCE PROGRAM
1971-1981
(In thousands of dollars)

STATE	WRITTEN PREMIUM	LOSSES INCURRED
Alabama	172	232
Arkansas	50	37
California	268	204
Colorado	358	436
Connecticut	334	577
District of Columbia	1,407	1,937
Delaware	57	21
Florida	3,284	4,346
Georgia	1,017	1,661
Iowa	19	13
Illinois	2,310	3,441
Kansas	222	550
Louisiana	...	...
Massachusetts	3,961	10,270
Maryland	1,215	1,420
Minnesota	43	14
Missouri	1,820	2,718
North Carolina	114	61
New Jersey	2,149	4,184
New Mexico	6	2
New York	38,730	125,967
Ohio	1,361	1,818
Pennsylvania	4,614	9,386
Puerto Rico	1,459	2,095
Rhode Island	280	733
Tennessee	1,036	1,722
Virginia	115	146
Virgin Islands	37	37
Washington	8	55
Wisconsin	23	9
TOTALS	66,469	174,092

Senator LUGAR. The Chair will now call a panel to discuss this general problem of Federal flood and crime insurance and riot insurance. The panel will include Charles Fritzel, National Association of Independent Insurers; Franklin W. Nutter, Reinsurance Association of America; James E. Jones, Jr., Alliance of American Insurers; George Bernstein, American Insurance Association; and J. Robert Hunter, National Insurance Consumer Organization.

Gentlemen, we deeply appreciate your coming this morning and your patience in appearing at this point in the hearing. As with the previous panels this morning, I would request that you limit your summaries to 5 minutes and we will engage in questions and answers and further testimony at that point. I would like for you to testify in the order that you were introduced. First of all, Mr. Fritzel.

STATEMENT OF CHARLES FRITZEL, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. FRITZEL. Thank you, Senator Lugar. You have our full statement and I will summarize as you have requested.

[The complete statement follows:]

STATEMENT OF
CHARLES H. FRITZEL
ASSISTANT VICE PRESIDENT FOR GOVERNMENT RELATIONS
NATIONAL ASSOCIATION OF INDEPENDENT INSURERS
BEFORE THE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
OF THE
BANKING, HOUSING, AND URBAN AFFAIRS COMMITTEE
UNITED STATES SENATE
APRIL 14, 1982

My name is Charles H. Fritzel and I am the Assistant Vice President for Government Relations of the National Association of Independent Insurers (NAII).

NAII favors termination of the Federal Riot Reinsurance Program and the Federal Crime Insurance Program. We support a viable National Flood Insurance Program and commend the recent actions by the Federal Insurance Administration (FIA) to put the program on a more businesslike basis.

NAII is a voluntary national trade association of over 500 insurers. Our organization provides a truly representative cross section of the property and casualty insurance business in America. Our members range in size from the smallest one-state companies to very large national underwriters, and consist of both stock and non-stock companies. NAII member companies reflect all forms of merchandising -- independent agency, exclusive agency, and direct writers; and they include insurers which serve a general consumer market and those which specialize in serving particular consumer groups such as farmers, teachers, government employees, military personnel, and truckers.

Federal Riot Reinsurance

NAII believes the need for the Federal Riot Reinsurance program no longer exists. Simply put, market conditions have caught up with the program. In the past, the artificially low rate of 2.5 cents per 100 dollars of subject premium attracted many insurers to the program because it was below the private market cost. On October 1, 1981, the Federal Insurance Administration (FIA) increased the reinsurance rate by tenfold to 25 cents per 100. This was done, in part, to rebuild the riot reinsurance fund which had been diverted for payment of crime insurance losses. The effect of the rate increase was to make the program competitive with the private reinsurance market.

We understand that fewer than 36 insurance groups currently are purchasing the federal riot reinsurance, down from nearly 300 last year. Reinsurance in force in the federal program for this fiscal year is 88% less than the previous year.

The fact that so many insurers, even after Congressional action last year in repealing the Holtzman Amendment, have not purchased federal reinsurance this year, demonstrates that the program has served its purpose and need not be renewed. The ability of state regulators to assure the continued availability of property insurance through FAIR Plans and the ability of private reinsurers to provide backing for insurers participating in the FAIR Plans is now a fact. The Riot Reinsurance program has served its purpose and now need not be renewed.

Federal Crime Insurance Program

The Federal Crime Insurance program is not insurance. It is a subsidy to businesses and residents of high crime areas. Last year it lost nearly $33 million. Since its inception in 1970, the program has lost nearly $170 million.

The program can hardly be called national in scope. About 71,000 policies currently are in force nationwide. Roughly 60% of these are written in New York State -- about 42,000 policies. The next highest state is Pennsylvania with about 5,000 policies, then Florida with about 4,000, the Massachusetts with 2,800. Roughly 75% of the program's coverage is written in just four states.

It is our understanding that the Federal Insurance Administration will recommend terminating the program. We support that position. NAII is willing to work with the New York state insurance authorities in developing a state program to replace the federal one. Insurance is a state regulated business and because we believe in state regulation and because so much of the program is written in New York, we think it is better left to the state and insurers doing business there to solve this problem.

National Flood Insurance Program

In 1977, the federal government took over the operation of the National Flood Insurance Program which, until that time, had been a cooperative effort with private insurance industry participation.

In the four years the federal government has run the program, we have had little contact with it. NAII supports a strong and viable National Flood Insurance Program and we favor its renewal. We applaud the efforts of Federal Insurance Administrator Jeffrey Bragg to put the program on a more businesslike basis.

Senator LUGAR. Thank you very much, Mr. Fritzel.
Mr. Nutter.

STATEMENT OF FRANKLIN W. NUTTER, REINSURANCE ASSOCIATION OF AMERICA

[The complete statement follows:]

STATEMENT OF THE
REINSURANCE ASSOCIATION OF AMERICA
CONCERNING THE
FEDERAL RIOT REINSURANCE PROGRAM

APRIL 14, 1982

The Reinsurance Association of America is a trade association representing professional property and casualty reinsurers in the United States. Reinsurance is the business of one insurer assuming all or part of a risk originally undertaken by another insurance company. A professional reinsurer is an insurance company which has as its principal activity the writing of reinsurance and is to be contrasted with insurance companies which directly insure the general public. The RAA's member companies assume more than $4 billion of gross reinsurance premiums annually.

The origin of the Urban Property Protection and Riot Reinsurance Act of 1968 lies in the widespread social disturbances of the 1960's. During that period, these serious conditions and uncertainties raised questions as to the continued availability of property insurance in urban areas. The Congress responded with the enactment of a program which authorized the federal government to offer riot reinsurance to insurers in those jurisdictions which enacted laws assuring the availability of property insurance for those unable to obtain it in the private market. In many cases, state legislatures elected not to participate in the Program or meet federal requirements. Federal riot reinsurance has not been available in those jurisdictions.

Even in those states in which the federal government now offers riot reinsurance, most primary insurers do not participate in the Program. In those cases insurers have concluded that adequate protection, competitively priced, from the private reinsurance market is available. Moreover, many reinsurers believe that the Program is unnecessary or improperly structured.

Requests have been made at times to compare riot reinsurance coverage available in the private market with the federal Program. It is difficult to make such a comparison because no private reinsurer offers coverage identical to the federal contract. The federal program can be described as an aggregate excess of loss reinsurance treaty providing coverage on specific lines of insurance; such as fire and extended coverage, other allied lines of fire insurance, and burglary and theft for losses arising from defined conditions of civil disorder in excess of a predetermined retention based on a company's previous year's premiums in each state. A company's aggregate retention in each state is five percent of direct premiums earned for covered lines in that state with a $1,000 minimum. Thus, in the case of an insurer having earned premiums of $1 million in a state, the retention would be only $50,000. Above this level, the federal plan could pay at least 90 percent of all losses incurred in the state resulting from the event.

In contrast, the private reinsurance market offers an excess of loss treaty providing protection against losses in excess of a predetermined retention per risk resulting from a number of perils, including riots. In the private market retentions are not determined on a state-by-state basis. Instead, an insurer's retention will be determined by its total capacity to retain a portion of the risk. The private market also offers catastrophe cover to protect primary insurers from the accumulation of individual losses arising from a single event.

These disparities in the method by which coverage is obtained in the federal Program as contrasted to the private market make it impossible to compare rates. However, it is clear that adequate reinsurance is readily available in the private market at reasonable rates. This availability in the private sector explains the mass exodus from the federal Program this year of more than two-thirds of the companies previously participating. This withdrawal has resulted in a reduction in coverage in force in the federal Program of eighty-eight percent from the last contract year, even though the number of participating states increased.

The Federal Riot Reinsurance Program was introduced because the coverage was thought to be unavailable in the private market although it was presumed needed to make necessary property insurance coverage available. To the credit of all involved, most states enacted FAIR plans to provide essential property coverage at reasonable rates. Today the states and the insurance industry are committed to the continuation of essential property insurance through FAIR plans.

Whether truly needed at the time or not, the Federal Riot Reinsurance Program served as a catalyst for the creation of these essential insurance mechanisms. It is important to know, however, that the existence of the Federal Riot Program is not a legal or economic condition for the continuation of these FAIR plans. Moreover, there is no evidence that property insurance availability is enhanced by the presence of the Federal Riot Reinsurance Program. In fact, the mere showing that only a small fraction of the qualifying companies buy the federal coverage is ample evidence that it does not affect coverage in today's marketplace.

In conclusion, the Reinsurance Association of America recommends that the Federal Riot Reinsurance Program not be continued beyond its current expiration date of September 30, 1982. While it is impossible to guarantee unlimited capacity or state unequivocally that future availability will always be adequate in the private market, present circumstances demonstrate that the federal Program is no longer needed to assure availability of essential property coverage.

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Senator **Lugar**. Thank you very much, Mr. Nutter.

Mr. Jones.

STATEMENT OF JAMES E. JONES, JR., ALLIANCE OF AMERICAN INSURERS

[The complete statement follows:]

TESTIMONY OF THE

ALLIANCE OF AMERICAN INSURERS

Mr. Chairman and Members of the Subcommittee, my name is James E. Jones, Jr., and I am the Government Affairs Representative for the Alliance of American Insurers. The Alliance is a major national trade association of more than 150 property and casualty insurance companies. Our members provide both personal and commercial forms of insurance protection in all 50 states and the District of Columbia.

We welcome this opportunity to present our views on the three Federal Insurance Programs administered by the Federal Insurance Administration.

I. The Urban Property Protection and Reinsurance Act of 1968 (Federal Riot Reinsurance Program)

Mr. Chairman and Members of the Subcommittee, on several occasions we have expressed our views to this Subcommittee concerning the reauthorization of the Federal Riot Reinsurance Program. We have stated, in good consciousness, that the Federal Program was not needed and strongly urged this Subcommittee not to reauthorize the Program. Our position has not changed during this period. In fact, today we are more convinced than ever that this Federal Program should be terminated.

The Urban Property Protection and Reinsurance Act of 1968 authorized the Federal Government to sell riot reinsurance to private insurance companies following the mid-1960's urban riots. The Act assured that essential property insurance would remain available in the urban areas, and other areas of the state, suffering from an inadequate property insurance market. The national advisory panel established by President Johnson in 1967 to study the problem of insurance availability in the riot affected areas of our cities concluded that a joint government/private industry program was needed. The Alliance, at that time, strongly supported that decision.

The Federal Riot Reinsurance Program has been in effect for 14 years. It has been a highly successful joint venture among private industry, state and Federal Governments. The Program has not necessitated any Federal funding to date. All the claims which have been paid from inception of the Act by the Federal Riot Reinsurance Program have come out of reinsurance premiums collected from participating insurers. In fact, premiums collected by the Federal Government at one time exceeded losses paid by approximately $140 million. It should be noted, however, that the Federal Insurance Administration has used this reserve to pay for the growing operating losses arising from the Federal Crime Insurance Program, and that this reserve is now depleted.

Insurers who participated in state pooling arrangements known as FAIR (Fair Access to Insurance Requirements) Plans were qualified to purchase the

Federal Reinsurance. FAIR Plans have been successful from a public policy standpoint in that they have provided the basic property insurance necessary for the reconstruction of our cities. They have also become an intricate part of the insurance market network. Some of the Plans have extended considerably beyond just providing essential insurance and are now offering to urban residents a choice of insurance coverages similar to that available in the voluntary market. The Plans in Illinois, Massachusetts, Rhode Island, Wisconsin and Ohio now issue a homeowners package policy.

As previously mentioned, the availability of Federal Riot Reinsurance was essential to the establishment of FAIR Plans. Today, however, market conditions have vastly changed. Private reinsurers have returned to the urban riot and civil commotion market. In fact, there is ample private reinsurance capacity today so that no primary insurers need to turn to the Federal Government for such a market. In our opinion, the service and benefits provided by the Federal Program can now best be provided through the private reinsurance market.

Because of the already reduced role, and the expectation on our part of further attrition of the Program through market forces in the coming months, we again urge that this Program be terminated. Its elimination will not have any adverse effect on the general availability of property insurance in urban areas. This assertion is based in part on a poll of Alliance members which we conducted several years ago. Our member companies tell us that reinsurance is indeed necessary for them to insure urban high risk areas. However, such reinsurance can be purchased through the private reinsurance market on terms and at a cost more favorable than the existing Federal Insurance Program. Furthermore, primary insurance can be made available, at reasonable cost, to homeowners and small businesses in inner city areas through the FAIR Plans even if Federal Riot Reinsurance is no longer available.

The continuation of state FAIR Plans is not dependent on the existence of the Federal Riot Reinsurance Program. There has not been an attempt to discontinue the operation of these state Plans in any of the nine states which no longer qualify under the Act.

All of the FAIR Plan states except three (Georgia, Maryland and Pennsylvania) have adopted legislation which assures that the Plans will continue to exist independently of the Federal Act and efforts are now being made in these three states to enact such legislation.

When the riot reinsurance reserve fund became exhausted, the FIA, on October 1, 1981, increased the premiums from $.025 per 100 to $.25 per 100. This amount, we believe, exceeds the rate charged by private reinsurers and has led to a dramatic shift by private insurers away from the Federal Insurance Program. When we appeared before this Subcommittee on April 7, 1981, we predicted that a large number of primary insurers would not continue to purchase the reinsurance from the Federal Government if the rate were increased. We understand that today only 98 insurance companies purchase the reinsurance, whereas there were 300 companies buying the protection during the previous contract year.

The Administration has made it clear that it wants to terminate those programs which have become redundant or those whose purpose can best be accomplished through reliance on the private sector. In our opinion, the Riot Reinsurance Program is an outstanding example of a Federal Program which can be terminated without loss of services or benefits to the community. The only justification for Federal involvement in providing insurance protection are when such coverage is essential or when it is not readily available in the private insurance market. Neither condition now exists!

Our members have taken into consideration the socio-economic condition of our depressed economy. They understand that predictions have been made concerning the possibility of civil disturbances arising during a hot summer. In spite of this, our members have re-examined the situation and made a positive business decision that Federal Riot Reinsurance is a program that has outlived its usefulness and is no longer needed.

II. Federal Crime Insurance Program

The Federal Crime Insurance Program was established under the 1968 Urban Property Protection and Reinsurance Act. The Act authorizes the Federal Government, as an insurer, to provide crime insurance at an affordable price in any state that has a critical crime insurance availability problem and does not have an appropriate state program to provide a solution. The crime insurance program became effective August 1, 1971.

The Alliance, in previous appearances before this Subcommittee, did not take a position on the reauthorization of the Program. We understand that now the Administration has taken the position that the Program should not be authorized for FY'83. We support this decision of the Administration.

In our opinion, the Federal Crime Insurance Program has not been a success and is a "social program" rather than an insurance program. The Program is subsidized by the Government in order for the premium to be affordable as required under the statute. To continue the Program, under this condition, a $50 million appropriation is required.

The lack of availability of crime insurance is not a national problem but an individual state problem. The bulk of the policies have been issued in New York, Pennsylvania and Florida. Approximately 77,000 policies are currently in force in 30 jurisdictions with 60 percent of the policies issued in New York.

In a state where a crime insurance availability problem has been demonstrated, a solution to the problem should be "tailor-made" to meet the needs of consumers for that state. We are willing to help establish an effective program in those communities where a problem exists and are committed to working with state administrations toward this end.

III. National Flood Insurance Program

The National Flood Insurance Program was established under authority of the National Flood Insurance Act of 1968. It is a subsidized, Government-supported program designed to help owners of real or personal property in areas designated as eligible for flood insurance, purchase such insurance.

The Alliance has been a strong and diligent supporter of the National Flood Insurance Program. Its members were most active in helping set up the Program prior to its enactment in 1968. Following enactment, we urged our member companies to fully support the development of the Program, to promote the sale of flood insurance policies, to offer claims and other service expertise and to participate with Government as risk-sharing partners. Today, we urge reauthorization of the National Flood Insurance Program.

During the first ten years of its existence (1968-78), the National Flood Insurance Program operated as a partnership between private industry and the Federal Government. In spite of the success of the cooperative program, the Federal Insurance Administration, for reasons of its own, decided to dissolve the partnership. FIA began to operate the Program unilaterally on January 1, 1978, predicting they could do it cheaper and better without private industry involvement. However, this has not proven to be true.

Abrupt termination of the agreement between FIA and private companies created extensive dislocation among companies which, in good faith, had established special servicing units. Many employees had to be terminated. The government action was very costly to participating companies.

The present Administration has indicated an interest in renewing the prior government/industry partnership. The Alliance has been asked to participate in an effort to help make the National Flood Insurance Program operate on a more businesslike basis. Our member companies have carefully considered the Federal Insurance Administrator's invitation to enter into discussions to explore the feasibility of renewed industry participation in the operation of the Program. Our members are willing to enter into such discussions under the following conditions:

- Agreement must be reached which provides that termination of a contractual agreement between industry and Government must be subject to prior Congressional approval and not at the discretion of the Administrator.
- The Flood Insurance Program must undergo a complete, non-government audit by a well recognized auditing firm.

It must be recognized that private insurers will need to be satisfied that whatever investments they would make to reconstitute a government/industry flood insurance partnership, would be for the long term. To establish the servicing facilities necessary to gear up for participation in the program would be expensive. Alliance members would thus want assurance, in advance, that termination of any new partnership would not be allowed to occur without good cause. Our members feel that the original contract was terminated without good cause and they would not want history to repeat itself. No one disputes the right of Government to terminate a contractual relationship with private industry if there are good reasons. What our member companies object to is the termination of a contract at the whim of an administrator. For this reason, our members feel that it is essential that the Federal Insurance Administration agree to an amendment to the Act which would require prior Congressional approval of the termination of any new agreement.

Because private industry has been totally excluded from participation in the Flood Insurance Program since January 1, 1978, it is only reasonable to require an independent audit if private insurers are going to consider returning to the Program as risk-bearers. It is a common sense business practice to require a full and impartial audit of any program in which one contemplates a major financial investment.

The goal of the Federal Insurance Administrator is to minimize direct Federal involvement in the Program. In this regard, FIA hopes to encourage participation by the private insurance industry in one or more potential alternatives which would improve the Program. FIA has sought input from the Alliance as to alternatives which would improve the present operation. The objective is to identify problems in the present operation of the Program so that steps can be taken to mitigate as many of the problems as possible, thereby creating a climate in which the Alliance, and other segments of the insurance industry, could participate and eventually make possible less direct government involvement.

Mr. Chairman and members of the Subcommittee, this concludes our prepared statement. Again, we thank you for this opportunity to present our views. I will be pleased to answer questions.

Senator LUGAR. Thank you, Mr. Jones.
Mr. Bernstein.

STATEMENT OF GEORGE BERNSTEIN, AMERICAN INSURANCE ASSOCIATION

[The complete statement follows:]

TESTIMONY OF GEORGE K. BERNSTEIN

On Behalf Of

THE AMERICAN INSURANCE ASSOCIATION

The American Insurance Association (AIA) was one of the leading proponents and supporters of the National Flood Insurance Program and the Urban Property Protection and Reinsurance Program, both of which were enacted in 1968. Since the passage of the Federal Crime Insurance Act in 1970, AIA has also supported the goals of that program.

After more than a decade of operation, Congress is again faced with the question of whether these three programs should be continued beyond their expiration date of September 30, 1982.

National Flood Insurance Program

The National Flood Insurance Program was enacted because broadly based, self-supporting private insurance against flood losses was impossible. Congress recognized that the flood hazard is essentially uninsurable. Floods combine the elements of low frequency of occurrence and high severity of loss that are inconsistent with a sound insurance program because of the inability to spread the risk and the resultant extreme adverse selection.

Comparatively few persons expect flood losses and only the most hazardously located of these choose to purchase insurance. Of those insured, a relatively high percentage actually suffers losses. Accordingly, with a small premium base from which to pay losses to those insured properties that are flooded, the premiums required from each insured to cover the exposure would be prohibitively expensive.

Congress appreciated these problems, and undertook the development of the National Flood Insurance Program with no illusions. The 1968 Act was a trade off. It provided that the federal government would compensate victims of flood losses who had already located in flood prone areas. However, with respect to new construction in areas where the flood hazard was known and documented, federal flood insurance would be available only if proper locational and construction decisions were made by communities and individuals.

Congress also recognized that the cost of flood coverage would be equally prohibitive whether it was sold by the federal government or private insurers. Thus, Congress provided for heavily subsidized premium rates for existing construction and established a federal mechanism for covering the deficit.

Subsidies against the real cost of coverage were at the heart of the National Flood Insurance Program. If subsidies had not been necessary, there would have been no need for a federal program. If subsidies had not been provided, a federal program would have been a failure.

Nevertheless, the Act directed that after appropriate technical information on the flood hazard had been provided to local communities, premium rates for new construction would be set on an actuarial rather than a subsidized basis. Congress so structured the Act for several reasons: no subsidy was intended for development that disregarded actual documentation of flood hazards; actuarial rates for new construction would create an economic incentive for safer development; and if proper construction practices were implemented, properties were likely to be sufficiently safe from flooding to permit premium rates that were affordable without a subsidy.

As Federal Insurance Administrator, I testified before this Subcommittee, the House program Subcommittee and the

Appropriation Subcommittees of both houses over a period of five years. Each time, I advised the committees that the flood insurance program was insurance in name only. Despite the fact that we know far more about flood damage and its mitigation than about such other hazards as earthquake, even the setting of actuarial flood insurance rates is far from a science. The unpredictability of wind and wave elements, the low frequency, high severity nature of the risk and the need to use such estimates as the "100 year flood" as a standard for both ratemaking and hazard mitigation, do not permit the precision that one would hope for in an insurance program.

Accordingly, massive losses and high cost to the Treasury were expected for many years until the location and quality of new construction and the premiums allocable thereto would overtake the risk represented by structures currently exposed to severe flood damage.

Moreover, Congress appreciated that with the premium subsidy and actuarial uncertainty inherent in the program, unless the hazard mitigation requirements of the Act were strictly enforced, the massive costs would be unjustified. Absent such enforcement, relatively inexpensive federally subsidized premiums would actually encourage irresponsible construction in flood prone areas. The result would be greater losses than would have occurred without a federal flood insurance program.

It should come as no surprise that the program has paid well over a billion dollars in claims, which even without the significant additional expenses of engineering and mapping and the administration of the program, far exceed premium income.

These costs constitute an investment in the long term goal of safer construction and wiser use of flood prone areas, and reflect the underlying premise of the program that eventually the cost to taxpayers would be less under a balanced flood insurance program than under the haphazard, ad hoc approach of disaster relief.

Whether this investment is paying off is a question which Congress must assess in determining whether to continue the commitment of taxpayer dollars to the subsidization of flood insurance. Under the 1973 Flood Hazard Protection Act, which mandates that flood insurance be purchased for any structure in a high hazard area if a mortgage is issued by a federally insured lending institution, the current $100 billion of federal exposure under this program will continue to grow. Only if the program is administered efficiently and the hazard mitigation provisions are wisely and earnestly enforced will the federal investment be justified.

The Federal Insurance Administration (FIA) has reaffirmed its commitment to the hazard mitigation aspects of the program. Nevertheless, there are very real pressures from private, local, state and federal sources who would prefer that enforcement take place in someone else's community or not at all. Unless the Congress and the Administration encourage the FIA to withstand these pressures, the goals of the program will not be achieved.

The new Adminstration of FIA has indicated its desire that private insurers again play a role in the flood insurance program. Until 1978, insurance companies bore a share of the underwriting risk of the program.* In addition, in return for servicing fees, private insurers issued policies and handled claims for the FIA. Since 1978, the federal government has taken over both risk sharing and servicing of the program, with the latter function contracted out to a non-insurer.

Inasmuch as one of the goals of the original flood insurance legislation was that the federal role would gradually diminish and be replaced by an increasing private insurance responsibility, eventually eliminating the need for any federal insuring role, the AIA welcomes the desire by the FIA to explore renewed private insurer involvement. The AIA, together with other segments of the industry, has already met with the FIA and the President's Commission on Housing to discuss this possibility. The AIA is prepared to assist the FIA and AIA companies will make their expertise available to the FIA in its efforts to restructure the program.

The Administrator of the FIA has recognized that a private risk bearing role is premature, and has stated that he does not seek such an industry commitment at this time. The AIA concurs with the Administrator, and believes that private risk bearing by insurers must await a number of developments. These include resolution of the issues raised by the GAO, the implementation by the Administrator of his 12 point operating plan, evaluation of the impact of the proposed premium rate increases, and most importantly, assurance that the hazard mitigation provisions of the 1968 legislation are being carried out and can be expected to have the continued support of Congress and the Administration.

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* The industry share was roughly proportionate to the ratio of the premium dollars actually realized through subsidized rates to the actuarial rate. Insurers also could purchase reinsurance from the federal government against excess losses.

Whether a private risk sharing program, similar to or incorporating the principles of the industry-FIA agreement that was abrogated in 1978, can be reconstituted, thus depends on an assessment of the fiscal and political climate to determine if a viable, soundly based flood insurance program is feasible, and if the insurance industry can work out a cooperative arrangement through which its interests and those of the public are adequately protected.

It has been suggested by the FIA that even in the absence of a private risk bearing role, insurers may be interested in acting in an administrative or servicing capacity to the National Flood Insurance Program. We are advised that the servicing agreement between FIA and its current contractor, EDS Federal, expires on September 30, 1982, but that FIA intends to extend it for one year. There are, no doubt, certain AIA companies that might wish to explore what role they could play to supplement or replace EDS Federal's. Among the open questions are whether insurers could bid, individually or as a group, on the servicing of certain jurisdictions or if the contract will be rebid on a country wide basis, and whether insurers will be able to bid on all or a portion of the functions now being performed by the contractor.

In any event, the AIA will certainly offer the FIA whatever technical assistance is possible, at the same time that the insurance industry evaluates the potential for a private risk bearing role.

Regardless of the extent to which the private insurance industry may participate in the federal flood insurance program, and even if there are substantial program changes, including establishment of higher actuarial rates, increases in the chargeable rates, larger deductibles, and other efforts to close the gap between premium income and payouts, no one should be under any illusion that the need for substantial federal subsidies will disappear.

Given the vast majority of "existing" structures that will continue to populate the program for years to come, and the Congressional mandate that such properties not be required to pay more than an "amount, consistent with the objective of making flood insurance available where necessary at reasonable rates so as to encourage prospective insureds to purchase such insurance and with the purposes of this chapter,"* premium income will be inadequate to support the program for the foreseeable future. Accordingly, the reasons why the private insurance industry was unable to provide flood insurance on a broad, self-sufficient basis, and why Congress enacted a subsidized program in the first place, continue to exist.

Urban Property Protection and Reinsurance Program

The riot reinsurance program was enacted as a response by Congress to the unavailability of property insurance in central city areas following the urban riots in the mid to late 1960s. Congress recognized that insurance availability problems would continue if private insurers were concerned about concentration of urban property exposures and uncertain of the availability of private reinsurance.

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* 42 USC §4015(b)(2)

The legislation established conditions that were to be met in assuring residents and businessmen basic property insurance coverage through state administered FAIR plans, but the 1968 Act did not interfere with the state ratemaking process or the prerogatives of individual insurers to exercise sound underwriting judgments. The American Insruance Association not only enthusiastically supported the 1968 legislation, but its companies were in the forefront in purchasing federal riot reinsurance.

Through the FAIR plans and directly, insurers have made significant amounts of insurance available in urban areas. Since inception of the program, some three million FAIR plan policies have been issued to residents and businessmen in the 28 states with FAIR plans. $1.8 billion in claims have been paid to FAIR plan insureds. FAIR plans have paid out almost $500 million more than they have received in premiums and investment income.

Unlike the federal flood insurance program, there has never been a subsidy of federal riot reinsurance premiums. Rates were to be set on the basis of the actual exposure of the federal government. From the beginning, the federal reinsurance rate took into consideration the existence of a state obligation to share in the federal losses, as well as the right of the FIA to assess private insurers (in addition to their premium payments), for a certain level of federal losses.

Not only has the federal government never subsidized private insurers in the cost of riot reinsurance, but after payment of losses and expenses, the government actually realized a surplus of more than $120 million from the sale of such coverage. Private insurers more than paid full price for the security of federal reinsurance.

Currently, however, only 36 reinsurance contracts have been entered into with FIA by private insurers, a fraction of the number in past years. Despite the fact that since the program began, AIA companies were the leading purchasers of the federal coverage, only one of 150 AIA companies has indicated that it purchased it this year. The primary reason for this drop in industry interest in federal reinsurance is the tenfold rate increase by FIA for the 1982 contract year. As the AIA predicted in its testimony before this Committee last year, there is little interest in a program with unrealistically high premium rates.

At 25¢ per $100 of coverage, the FIA rate is grossly excessive, has no relation to actual past or anticipated future riot losses, and few insurers are willing to pay such a price when private riot reinsurance is available at substantially lower cost. In fact, FIA does not even claim that the 25¢ rate is needed to cover expected riot losses, but has set that rate to produce a surplus to fund the losses generated by the entirely separate Federal Crime Insurance Program.

At this time, the entire $120 million that was realized as profit from the sale of riot reinsurance to private insurers has been used up by the FIA to pay crime losses. There are no reserves left to cover future federal responsibilities for riot losses. If such losses occur, these costs will have to be funded, at least initially, by borrowing from the Treasury, and the potential exists for assessments against insurers who remain in the program. Not only has this development reduced the soundness of the federal program, but it adds another disincentive to insurer participation at this time.

Accordingly, as private market riot reinsurance is currently available at reasonable cost, and as insurers believe that they are better prepared today to respond in an orderly fashion following an outbreak of serious rioting, few companies can be expected to purchase the high priced federal coverage.

Nevertheless, over the years, the federal riot reinsurance program has succeeded in encouraging the availability of essential insurance in urban areas and despite the drop in the number of insurers that are purchasing the federal coverage, the AIA believes that the continued existence of the program is necessary.

Many insurers, particularly smaller ones, still purchase federal riot reinsurance and the AIA would not deny them the opportunity to retain this security. Moreover, if circumstances change, and if federal riot reinsurance again becomes critical, as it did in 1968, it would seem unwise to terminate the program only to have to seek new legislation to resurrect it.

Under the existing legislation, no insurer is required to purchase the federal coverage, and its availability is unlikely to impose financial costs on any insurer that chooses to obtain its riot reinsurance only in the private market. Those insurers that oppose the program are free to ignore it without penalty or burden.

Furthermore, the cost to the federal government of retaining the program is minimal. Since inception in 1968, total program expenses have been only $4 million. Against these costs, the government has netted $120 million over the life of the program, even after payment of all reinsured losses.

The advantages of continuing the federal riot reinsurance program impel the AIA to urge extension by the Congress.

Federal Crime Insurance

In enacting the Federal Crime Insurance Program in 1970, Congress acknowledged that crime losses in certain urban areas were as uninsurable as those from floods.

The 1970 Federal Insurance Administration Report, which preceded the Congressional action, found that:

> "The choices we have as a society are not easy. We must decide not only whether we want to save our urban areas, but also whether we are willing to pay the price. This report demonstrates that traditional insurance approaches are inappropriate to the problem of crime losses in the areas most seriously affected. It is impossible for the residents of these areas to bear the full financial burden of either their uninsured losses or their own insurance costs as traditionally determined under the rating laws of the several States. If we are to compensate these residents for crime losses, the cost of this compensation must in part be borne by others."*

Following issuance of that report, Congress chose not to rely on state solutions to the problem, and developed a direct federal program to compensate crime losses. As with federal flood insurance, there were no illusions that the program would be self-sustaining, and Congress decreed that premiums were to be "affordable", rather than actuarially sound, so that residents and businessmen in high crime areas could purchase the coverage. While it was intended that in the early years of the program costs would be advanced from the riot reinsurance surplus in the National Insurance Development Fund (NIDF), it was understood that appropriations would ultimately be required. No such appropriations were made and crime insurance losses have wiped out the more than $120 million surplus of the NIDF, which as of the end of FY 1981, showed a deficit of more than $7 million.

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* Report on Availability of Crime Insurance & Surety Bonds in Urban Areas, Federal Insurance Administration, U. S. Department of Housing and Urban Development, 1970, p. 3.

Despite extensive protective device requirements, which private insurers would find difficult, if not impossible, to enforce, the federal government has paid more than $3 in losses and expenses for every dollar of premium income--about $200 million has been expended against approximately $60 million in premium income. Nevertheless, such losses are consistent with the Congressional intent in enacting a program that was not true "insurance", but was a response to a social problem of such scope in certain states that private solutions were unlikely.

Nothing has changed in the last twelve years to bring the reasoning behind the premium structure of the 1970 Act into question. Excessive crime losses, concentrated in heavily populated urban areas would still require insurance premiums that, without a subsidy, would prove prohibitive, regardless of whether such coverage was sold by the federal government or by private insurers.

The federal government may choose to reevaluate its decision that the social problem of crime losses should be addressed by a government program, or that on a relative scale of values, crime insurance ranks sufficiently high to justify the costs that must ultimately be borne by the Treasury and the taxpayers. But the actual experience of the Federal Crime Insurance Program is devastating proof that compensation for losses from crime cannot be accomplished without a subsidy.

Program adjustments, including premium increases, may be warranted, but neither they nor increased deductibles nor stepped up enforcement of protective requirements will alter the basic need for subsidies in multiples of the premiums charged.

Undoubtedly, there are states in the Federal Crime Insurance Program where both number of insureds and losses are minimal enough for coverage to be provided through private or state mechanisms. However, in high crime areas where there is significant demand for the coverage, the magnitude of the exposure precludes private, non-subsidized solutions.

Insurers must base their rates on actual experience, and the private insurance mechanism is not structured to provide the extensive subsidies required by a social insurance program. As long as government desires an "affordable" premium structure to insure against a severe social problem, the federal crime insurance program is the most appropriate method for providing crime insurance to high risk insureds.

The American Insurance Association has supported the federal flood, riot and crime insurance programs since their inception. Whatever approach is taken on the continuation of these programs, the AIA and its companies will continue to work with the Congress and the Administration to help make essential insurance coverages available.

Senator LUGAR. Thank you, Mr. Bernstein.

Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. HUNTER. I would like to preface my prepared statement by saying that I am pleased to hear Mr. Bernstein's remarks on behalf of the American Insurance Association and to affiliate myself with them.

[The complete statement follows:]

Statement of

J. Robert Hunter, President
National Insurance Consumer Organization

Mr. Chairman and Members of the Committee, it is my pleasure to be here today to discuss with you the programs of the Federal Insurance Administration (FIA).

Flood Insurance

It is indeed unusual for me to testify in a hearing where extension of the flood insurance program is the least controversial proposal. I fully support its continuation.

There is controversy in the program, however, that demands careful Congressional review, and that is the direction that FIA has embarked upon in the program. As I understand it, FIA wants to eliminate the federal subsidy by 1988 and wants to more fully involve the private sector in the program.

Elimination of Flood Insurance Subsidy by 1988

In enacting the National Flood Insurance Program, Congress carefully and thoughtfully designed a long-range plan to disengage the federal taxpayer from the sharply mounting costs of unwise flood plain occupancy. In return for subsidized flood insurance on existing structures and other federal support for construction and acquisition of structures in high flood risk areas, Congress required safer construction within federally designated flood-prone areas.

The quid pro quo has worked. Over 17,000 communities are now enforcing flood plain management's minimum land use controls; nearly 2 million policies of insurance are now in force.

New structures built in flood plains in regular program communities are built much more safely and pay full actuarial rates for insurance (of all the insurance sold in all flood-prone communities, nearly 90% is in regular program communities). Over time, as the existing inventory of structures in flood plains is literally or figuratively flushed out of the nation's housing inventory, and as new construction occurs, the proportion of the insured population paying full rates will increase, until it becomes possible to end all subsidies from taxpayers by adding a small surcharge to all policies written under the program. I project that that might possible as early as about 2010.

While raising rates fairly and gradually to lower taxpayer costs is a concept we can all endorse, to eliminate the flood insurance subsidy by 1988 will prove either impossible or, if realized, catastrophic. To achieve it would be a breach of faith with those communities that enacted, often under great pressure, the flood plain management standards. It would be a breach of faith with those living in flood plains who count on the program's affordable rates and complete coverage. Coupling the requirement on lenders to require flood insurance with insurance suddenly becomming unaffordable will force lenders to call mortgages and thus drive people from their homes. This cannot be tolerated.

Not only that, it is obvious that a good part of FIA's strategy to eliminate taxpayer subsidies by 1988 is predicated upon jacking up the deductible to high levels. This has already begun. Now here is a shell game if ever there was one. First of all, the casualty loss under the higher deductible is available for tax write-off; and who pays for that? The taxpayer! Second, the below the deductible costs are (foolishly, I think) eligible for disaster relief; and who pays for that? The taxpayer! Thus these "savings" for taxpayers are largely illusory.

Worse, perhaps, is the potential this scheme has for undermining the program's support. If people and communities see this as a breach of faith and developers seize upon this opportunity to kill the program, the big loser in the long run will be the very taxpayer that FIA claims to defend via lowered subsidies.

This potential danger requires your careful oversight.

Private Involvement in NFIP

The private competitive insurance market should be actively involved in the program. Insurers should actively compete among themselves and with the servicer of the program for the actuarially rated business. Insurers should also advise the program regarding new insurance techniques which might make the program work better for flood insurance buyers.

Insurers should also fully compete, company by company or in groups of companies, for the contract for the servicing of subsidized insurance. Non-insurance entities, such as EDS and others, should freely join in that competition. Since subsidized flood insurance will, over the long pull, pay out more in claims than it takes in in premiums, it is the taxpayer who bears the full cost of servicing the subsidized insurance program. Taxpayers deserve the assurance that only competitive bids give them that this cost is minimized, consistent with quality service.

However, if by "private sector involvement" the Administration means to revive the old "partnership", I want to remind them that the last "partnership" with the National Flood Insurers Association (NFIA) collapsed.[1]

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[1] The breakdown in relations came about when NFIA refused to pay claims it was ordered to pay by Secretary Carla Hills (the claims denied were made by those who had, following a Corps of Engineers order to evacuate, moved their furnishings out of the path of a flood — thus incurring removal expenses.

In short, unless the issue of Secretarial Authority is settled by Congress, FIA should not reenter the expensive "Twilight Zone" of a "partnership" with insurers; funded by the taxpayer.

The Urban Programs

Turning to the Urban Property Protection and Reinsurance Act of 1968, it is my recommendation that you either extend the programs or legislate a responsible disengagement of both the Federal Crime Insurance Program and the State FAIR Plan requirements, while retaining the capability to provide riot reinsurance.

The Need to Retain a Federal Riot Reinsurance Capability

The need for a federal riot reinsurance capability is obvious: private reinsurers will sell affordable riot reinsurance as long as there are no riots — but no longer. The experience of the 1960's stands as stark evidence of this point. When riot reinsurance vanishes, private direct insurers flee the cities leaving "communities without insurance (which) are communities without hope."[2]

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1. (continued)
NFIA agreed that paying such claims would lower the overall program costs, but refused to pay on the grounds that it would be bad precedent for their privately written insurance contracts). A second point of concern HUD had was that NFIA had refused to competitively bid for servicing sub-contracts. Under the NFIA approach, sub-contracts were negotiated without competition the vast dollar bulk of which went to NFIA executive committee companies, which was effectively negotiating with itself.

Negotiations between HUD and NFIA were undertaken, the key stumbling block being NFIA's adamant refusal to accept HUD's authority over budget expenditures; following several years of negotiations between NFIA and HUD (under Presidents Ford and Carter), NFIA terminated the contract.

HUD then solicited competitive bids for servicing the program, under which NFIA refused to bid, preferring to mount a political and legal attack, both of which failed. EDS won the competitive bid, cutting NFIA costs about in half, prompting Senator Proxmire to award to then-Secretary Patricia Harris his rare "Golden Taxpayer Savings Award." (the attached April 6, 1982 letter to the Chairman of the House Subcommittee on Housing and Community Development details this point.)

[2] Meeting the Insurance Crisis of Our Cities — A Report by the President's National Advisory Panel on Insurance in Riot Affected Areas, 1968.

In these economic times, with unemployment and falling expectations leading to predictions we all pray do not come to pass, it would be foolish to abolish the federal riot reinsurance capability.

Crime Insurance and FAIR Plans

Riot reinsurance is made available only to insurance companies participating in FAIR (Fair Access to Insurance Requirements) Plans, which make essential property insurance available to those who can't buy it privately. This is as it should be conceptually: the government will assist the private sector if the private sector will assure the government of its willingness to provide essential services. Thus, as in flood insurance, the government has a valuable quid pro quo for its involvement.

FAIR plans exist in 28 states. They currently write essential insurance covering one million structures.

Crime insurance is sold directly to the public by the federal government in areas where there has been a finding of unavailability or unaffordability of private insurance. This program now protects over 70,000 homes and businesses.

By What Authority Did Congress Enact these Programs?

Insurance has been federally regulated since 1944, when the Supreme Court found insurance to be interstate commerce.[3] Congress had, and still has, several options regarding how to exercise that regulatory authority. For instance, Congress could:

(1) Fully apply the anti-trust laws to insurance and impose SEC and FTC-type oversight, or

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[3] United States v. Southeastern Underwriters Association, 322 U.S. 533 (1944).

(2) Exempt the Insurance Industry from Anti-Trust laws and

- (A) Establish a new agency to regulate insurance, or
- (B) Delegate some aspects of insurance to the states while retaining some federally, or
- (C) Delegate regulation to the states under federal standards and oversight, or
- (D) Delegate regulation to the states with essentially no standards and no oversight.

Congress, in 1945, selected the latter approach (i.e., 2D)[4], and has not reviewed the situation since, in any detailed or systematic way, except for a couple of GAO reports. Congress has, from time to time, on a piecemeal basis, analyzed and taken action in one are of insurance or another (the programs we are discussing here today are examples) when state regulation can't cope in a way that is so obvious that it cannot be tolerated at the National level.

Do We Need these Urban Programs Now?

The obvious answer is: you can't make urban enterprise zones work without them, or something like them, in place. Certainly, the Congress has here established property insurance residual markets which have benefitted America through, over ten years, providing essential insurance that would otherwise not have been available. Many millions of policies have been issued under these programs.

Yet, these programs, while performing their essential function, have institutionalized anti-competitive insurer behavior which deprives all of America of more efficient insurance systems.

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[4] McCarran-Ferguson Act, PL 79-15, 59 Stat 33, 15 USC S 1011-1015 (1945).

In 1974, the FIA published a landmark work called Full Insurance Availability.[5] It's prime finding was:

> The keystone in the arch of deficiencies in the property insurance residual market -- indeed within the total property and liability insurance market — is continuation of the absolute right of insurer underwriters to deny essential insurance to applicants without reason or for arbitrary and capricious reasons which are entirely subjective in nature and which may have more to do with the insurers competitive moods, modes and postures than with the objectively determined loss-potential characteristics of the risks.

The report called for state action to eliminate FAIR Plans, Crime Insurance Plans and other residual market mechanisms in favor of the Full Insurance Availability (FIA) System under which "all insurance risks would be able to purchase insurance from the insurer of their choice and would not be forced into separate, less adequate and more costly FAIR Plan . . . markets." Only five states for auto insurance and one for fire and homeowners have been able to overcome tremendous insurer lobbying against the concept.[6]

The Urban Plans: Their Impact on Competition

The availability of residual market mechanisms such as the FAIR Plan and Crime Plan has thwarted meaningful price and service competition by easing the capability of insurance company substitution of selection competition for price and service competition through providing a convenient "dumping ground" for insurers to place redlined or other subjectively discarded applicants for insurance. This activity, and the widespread knowledge of it among the public, freezes the market, making shopping for insurance far less practiced than for most purchases.[7]

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[5] Full Insurance Availability, Federal Insurance Administration (US Department of HUD), September, 1974.

[6] MA, MI, NH, NC and SC for auto. In Michigan, the State Supreme Court found that insurer denial of coverage violated constitutionally protected due process rights. Michigan is the only state to require Full Insurance Availability for fire and homeowners insurance as well as auto insurance. Hawaii has a form of the FIA system in place for auto insurance as well.

Selection competition is a very abusive practice, as Full Insurance Availability points out:

> The interface between these respective imperatives, as the applicant for insurance seeks the insurance which society has decreed he must have, and as the insurer seeks competitive success through selectivity, produces inevitable conflict and has left an ever-widening gap to be filled by residual . . . market mechanisms.

As former New York Superintendent Benjamin R. Schenck put it:

> Selection competition should have few admirers. It is capable of totally denying to some people the opportunity to buy insurance at all in a day when many forms of insurance have become legal and practical necessities.

If selection competition was eliminated, the supply and demand sides would become balanced and competition among insurers in price and service would be greatly enhanced. If this were coupled with good insurance information, consumers could shop and act upon what was best for them. They cannot today.

One of the Members of the House Subcommittee on Housing and Community Development, Representative LaFalce of New York, has wisely asked GAO to review the costs to America of many of the other non-competitive activities insurers engage in under the McCarran-Ferguson's anti-trust exemption. These activities include:

- o Cartelized ratemaking;
- o Establishment of retail level (agent's) prices by the wholesale level (the companies). Insurance is one of the few parts of the economy still acting under the "Fair Trade" type anti-competitive situation;
- o Prohibition, under state law, of groups forming to purchase insurance at reduced rates (the "fictitious group" laws prohibit even employers from offering employees low-cost, true-group auto insurance, for example).

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[7] Particularly coupled with lack of disclosure of meaningful price information. The Full Insurance Availability Report prophecied that these FAIR plans would become "dumping grounds", viz: "While affording a handy dumping ground for

With all of these anti-competitive elements in place, it is no wonder that insurance premiums eat up 11.7% of the nation's disposable income, yet pay out less than 50¢ for each dollar of income. In his best-selling new book, The Invisible Bankers, Andrew Tobias finds that insurance is grossly inefficient, perhaps employing one million too many employees. As Tobias puts it:

> Roots of the industry's inefficiency are manifold. The fire insurance business grew up as a massive exercise in price fixing. The life insurance business is dominated by giant mutual insurers whose managements have no one to answer to but themselves. They are motivated toward growing larger, not leaner. One might expect the marketplace to impose its own economic discipline -- it is competition based on price that has always been the surest spur to efficiency -- but insurance prices, particularly life insurance prices, are notoriously hard to evaluate, leaving consumers unable to spot the best values and insurers under little pressure to provide them. Federal regulation and antitrust statutes largely exempt the insurance industry; state regulators are anxious to keep even inefficient companies profitable, lest policyholders be left stranded or claims go unpaid. Then, too, there are the problems of policyholders gleefully defrauding their insurers and of insurers callously chiseling their insureds -- an inherently inefficient and seemingly irremediable circle of distrust.
>
> There are ways to improve the system radically. But this is not an industry, by and large, that seeks radical improvement. Inbred and living in comfortable isolation with its state regulators, it has been slow to innovate. A "cash cow" of the first order, it has resisted change.[8]

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7. (continued)
subjectively determined "bad" risks (the worst aspect of which may be their failure to fit the insurer's competitive mode), the plans likewise furnish an escape valve which has, thus far, preserved the traditional and hitherto sacrosanct perogative of the insurer to be arbitrary in the exercise of its underwriting judgments. There appears to be considerable basis for an inference that the plans have unintentionally provided a new vehicle for stepping up the abandonment of urban core areas by individual insurers."

8. Tobias, Andrew. The Invisible Bankers, New York: Linden Press, 1982, pp. 24 - 25.

Mr. Tobias' book should be required reading for every member of Congress.

In the event you believe that the point of view that insurance is not competitive is held only by consumers, an analysis (attached) of this matter by the investment firm of Mabon, Nugent and Company is of interest. Note that the report concludes (at page 3) that:

> Competition for personal lines has clearly ended . . . major insureds have decided . . . to raise rates by as much as 15 percent. Most insureds will remain with their current insurers due to fear of cancellation or lack of access to alternatives . . . the result is neither conspiracy nor cartel but it might as well be.

Also, in discussing the major personal line of auto insurance (at page 26) the report says:

> What is remarkable is the ability of major companies to make rate increases stick despite a healthy ROE. Some reasons are (1) the distribution system has an inherent inefficiency that creates insurmountable problems (in the short term) for a new, price-cutting competitor; (2) the major companies (including the ISO companies) use a rating system grounded in underwriting profits rather than broader measures of profit; and, (3) Low leverage industry-wide clouds the issue. On the other hand, combined ratios of 108 percent would have produced a net loss in the past (the location of some managements).

The Urban Plans: Redlining Implications

Several years after the availability of these programs, HUD reported[9] that the Full Insurance Availability Report's prediction of the FAIR Plan's exacerbating redlining had come to pass:

> ". . . insurance redlining is widely practiced by insurers."
>
> Insurance companies redline by means of zip-code. As a result risks are rejected not on the basis of objective underwriting standards but rather on a highly subjective perception of risk assumed for general geographic location.
>
> Redlining has an undeniable racial component . . . correlation tests show that FAIR Plan policies are slightly more likely to be written in a black or Puerto Rican neighborhood than in a neighborhood that contains building violations.
>
> Insurance redlining today denies many urban property owners access to a voluntary insurance market. The practice is not based on any sound underwriting standards but rather on highly subjective criteria that would appear to result from unfounded generalizations or preconceptions about urban property risks. The effect of this practice is that many property owners are denied access to insurance at affordable prices. Consequently, what mortgage financing is available becomes even more difficult to obtain. Economic life and opportunity for jobs are closed by this practice as business cannot expand without affordable insurance protection. Redlining relegates healthy risks to the residual insurance markets where they pay more for less coverage than their voluntary market counterparts. In short, redlining hastens the decline of neighborhoods and becomes a self-fulfilling prophecy. Any Federal, State, local and private efforts to maintain, let alone restore, our cities, will not succeed if insurance redlining is not arrested. The future of America's cities depends upon early resolution of this national problem.

This Report led to Congress passing the widely debated Holtzman Amendment, which tried to control the most blatant manifestation of redlining: high rates. It was a good concept to help patch up what years before Full Insurance Availability prophetically saw as a flawed approach (because of its institutionalization of second-class citizenship for redlined citizens) even when manual rates are equalized, viz:

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[9] Insurance Crisis in Urban America, Federal Insurance Administration, 1978.

> Even where FAIR Plans are not overtly self-rated, instances of distinctions in rates or rating practices abound, such as the imposition of condition charges and binder charges. Although risks in the voluntary market may be nominally subject to condition charges, in practice, expense constraints on insurers, and producer resistance, result in dwelling risks rarely being inspected with a view toward assessing condition charges in the voluntary market. By way of contrast, in the residual market, inspection of risks, including dwellings, is practically universal . . .
>
> The pervasive problem of coverage limitations is basic to the residual market risk and exists regardless of the mechanical format utilized by FAIR Plans. The residual market risk lacks access to the variety of the coverage forms and combinations available within the voluntary market from a variety of insurers. By virtue of his having been labeled an unacceptable risk (perhaps for no other or better reason than cancellation by some insurer of the agency contract of his agent), the residual market insured finds himself at the mercy of an involuntary market mechanism which offers little or no choice in coverage options.

But now, thanks to clever, "back door" legislative tactics, the Holtzman Amendment's protections are gone.

A PROPOSAL TO INCREASE INSURANCE COMPETITION WHILE ELIMINATING FEDERAL CRIME AND FAIR PLAN INVOLVEMENT

The Congress should amend Public Law 15, the McCarran-Ferguson Act, to require, as a standard for continued state regulation of the insurance business, that states enact Full Insurance Availability programs so that "good" risks, regardless of location or other subjective characteristics could get insurance from the company of the customer's choice. "Good risks" for fire insurance could be defined in terms of previous experience, compliance with fire codes, lack of arson history, etc. For crime insurance, the definition could include locks and other anti-crime devices.

The only way I can see for Congress to terminate these important programs is to create the climate where state systems will serve all of the legitimate insurance needs of America through the private, competitive market. As Full Insurance Availability pointed out:

> . . . the proposed reform . . . would . . . reverse the movement toward more Federal involvement . . . the Federal Crime Insurance Program could be completely withdrawn . . . FAIR Plans could also end, although Federal riot reinsurance could still be provided to insurers desiring it.

That is as true today as when it was written in 1974.

Further, this reform would enhance competition in price and service by eliminating selection competition for those risks qualifying under the "good risk" category. It is my belief that tens of billions of dollars will be saved if Congress would simply require insurers to deal for "good" risks as Congress defines that term, and if the National Insurance Consumer Organization, the states and others continue to develop needed consumer shopping guides to fill the current information void.

Conclusion

Please think, if you will, of today's economy, crying out for more productivity and lower out-of-pocket consumer cost; think of the insurance industry's gross inefficiency, eating up — like PAC-MAN — almost 12% of the nation's disposable income, yet paying back less than 50¢ for every dollar of income over the last twenty-five years.[10.] Think of this mammoth industry, free of anti-trust law application or any other federal oversight, running loose in our economy; think of the anti-competitive behavior in which insurance companies engage; think of the delegation of regulation Congress made to the states in 1945 without standards for performance and without continuing oversight; think of the GAO's finding that "there are serious shortcomings in state laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States."[11] Think most of all of the citizens in our cities who are redlined and dumped into the FAIR Plan, Crime and other residual markets, or even into no market at all where these plans do not exist.

If you think of these things, and I believe that you must, you will not simply terminate or simply extend these important urban programs. Rather you should adopt the readily available alternative of making this industry more competitive, more efficient and more responsive to America's essential insurance needs through adoption of the simple standard that insurer's deal with insurable risks as a condition for continued state regulation of insurance under the McCarran-Ferguson Act.[12]

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10. Excluding life insurance, pension plans and other accumulation of cash value programs which are expected to hold large portions of premiums.

11. Issues and Needed Improvements in State Regulation of the Insurance Business; General Accounting Office, October, 1979.

12. Alternatively, this might be accomplished through creative repeal of the Anti-Trust Exemptions (an outcome encouraged by President Ford's Justice Department Commission on Anti-Trust Immunities in its report on The Pricing and Marketing of Insurance, January 1977; and by the National Commission for the Review of Antitrust Laws and Procedures, in its Report to the President and the Attorney General, January 1979.

Senator **Lugar**. Mr. Fritzel, from your experience in Miami, were riot insurance policies in effect during the disorders there recently, and how did such coverage work, how extensive was it, and was it discontinued in any case after the riots were concluded?

Mr. **Fritzel**. There was riot insurance in effect by the private insurance industry. Florida does not have a FAIR plan and there was no Federal reinsurance involved. The private industry did meet its obligation, paid those losses in Miami, and it's my understanding there has not been any withdrawal from the market by the private insurance companies as a result of those riots. The exact figure I cannot recall right now. I think it was something like $150 million. Perhaps one of the other panel members has that figure.

Senator **Lugar**. But this was entirely a private insurance.

Mr. **Fritzel**. That was entirely a private insurance mechanism. There was no Federal program in Florida. Florida does not have FAIR plan and does not purchase the Federal riot reinsurance.

Senator **Lugar**. Let me pose a question related to this. Mr. Bernstein and Mr. Hunter have proposed a very logical proposition that brought about consideration of riot insurance during 1968 by the Congress. As a mayor of a large city at that time I'm fully aware of the very real difficulties that faced urban areas and the pervasive fear of small business people and homeowners at that stage.

Why isn't it logical to assume, as has been argued today, that because the country has not suffered urban riots in large numbers in recent years, this is a subject that passes from view, but could rapidly come back into the view of the Congress in the event that such riots occurred. In other words, to what extent is there value in the thought that even if the riot insurance program has only 98 companies that purchase this reinsurance you ought to leave it on the books because that would be helpful in the event that you didn't go back to square one again if riots occurred and some mechanism was required. Why terminate the situation?

Mr. **Fritzel**. Well, we think we've learned something from enactment of this legislation. Back in the late 1960's the industry was frightened. It was the first experience we had had with massive urban riot situations. As it turned out, after the program was enacted, the industry has been able to handle similar losses as you cite in Florida in which the Federal program wasn't even involved. We feel that the market conditions have changed, that we've learned something since those days, and that the reinsurance will remain available now in the future. It's a matter of faith, I think, in our own system.

Senator **Lugar**. Mr. Bernstein, why would the riot insurance be of such importance to New York as opposed to Florida? It seems to be the case that in New York and large Pennsylvania cities, there's been a feeling of dependency upon riot insurance. Other urban areas in the country that are potentially volatile simply didn't come into the program in the 1960's and therefore evolved in a different way. How can you explain the large concentration of interest in policy holders in New York State and Pennsylvania, for example?

CRIME VERSUS RIOT INSURANCE

Mr. **Bernstein**. I would distinguish first the concentration of crime versus riot. With respect to the first part of your question, after the riots in the 1960's and as you recall we started off in 1964 with Watts and Rochester and by 1967 we got more intensive riots, the dryup didn't happen all at once. Of course, once you focus on the fact that the primary property and casualty industry writes almost 100 billion dollars' worth of insurance as opposed to the $4 billion that the reinsurance industry writes and recognize which is the dog and which is the tail. The Federal potential backup with the full faith and credit of the Federal Government is theoretically unlimited, although the borrowing authority is only up to one-quarter of a billion dollars, but when the riots occurred and the States enacted their legislation, they were enacting legislation in response to Federal legislation.

One of the very wise provisions at that time in the Federal legislation was a requirement of 5 percent State share, that the State share in the potential cost of these riots. Some States chose just not to do that. Florida was one of those States because Florida very seriously did consider a riot reinsurance program and I think it goes back—and I'm not sure, but my recollection is Florida may have been one of the States that did come into the Federal program during the interim before the mandate for the 5 percent took effect. I may be wrong there but, in any event, I do know when I was the Federal Insurance Administrator in discussion with the Florida people that they were very seriously considering it. They felt it had hazards. Some States felt they had worse hazards than others. By and large, the industrial States with concentrated urban areas were more concerned with riot exposure and therefore with the need for the coverage.

With respect to crime insurance as to why one State has such a high concentration of coverage as opposed to others, I know I searched for the answers during the 5½ years I was the Federal Insurance Administrator. We never found them. We found that advertising didn't do the job. We found that with a really special arrangement whereby the the insurance commissioner in the State of Pennsylvania licensed agents just to sell the program and we paid a finder's fee to the Urban League—we only sold 20 more policies that year than the last.

Insurance is sold by agents and brokers, but usually people only learn about that coverage from their agent or their broker and the commission level in the crime program is low enough because of the relatively low premium that it is not an attractive sales device. As a result, brokers in some States have not been as active in pushing it as in other States.

In New York there's been more publicity than in other States. As Mr. Bragg did point out, many middle class people—I wouldn't call them wealthy, but middle class people purchased the crime coverage because they found that crime coverage on what may be called valuables but to them represented their lifetime savings was essential—they went to work and they were home alone and there was no one to protect them and that was very important. But the businessmen, the 20,000-odd businessmen in the country that have purchased this—I know personally in the District of Columbia, many people couldn't get consignment of goods from their wholesaler until they showed evidence they had crime insurance—they couldn't be in business without crime insurance, and in some States that message is brought home more than in others.

Senator **Lugar**. But your assertion is that in addition to being historically true in 1968 and as you've traced it through your own extensive experience as commissioner, that that would still be true today? In other words, in the District of Columbia you just mentioned, there would be businessmen here, presumably small businesses, who would be unable to obtain proper insurance without this Federal backup.

Mr. **Bernstein**. Absolutely. The coverage is available but because of the high losses, the rates that are approved by the State Insurance Department—representing experience—are too high for those people to pay, therefore there is the need for the type of subsidy of the Federal program. Without that subsidy the coverage would be available but the people couldn't afford it. Private insurance—free enterprise cannot sell below cost. In fact, it's prohibited. That's why the Federal Government is the only way.

Senator **Lugar**. Once again, the affordability situation, because it's a difficult thing to define as to what is too high and what is prohibitive in fact, as I gather, listening to your testimony, the rates would be of a multiple of the ordinary. In other words, it's not a question of there being 10 or 15 or 20 percent higher, but maybe 200 or 300 percent higher, something of that order, for small businessmen in the District of Columbia.

Mr. **Bernstein**. I don't have the District of Columbia figures, but nationwide the price increase would have to be 300 percent and in New York even higher.

Senator **Lugar**. I don't want to characterize testimony unfairly, but you're suggesting that the subsidy to the small businesses in the District of Columbia might be coming in the form of this crime insurance. There is a subsidy going on here and obviously there is with regard to all the taxpayers in the country, and that it may be a subsidy in this case of keeping small business people alive in various innercity areas.

Mr. **Bernstein**. It's 20,000 small businessmen and it is small business not large business because of the rate structure which increases as the gross receipts increase.

Senator **Lugar**. A further question, of course, that all of you have pointed out, is what the incidence of this subsidy should be. Is it indeed a national problem? Should taxpayers in the State of Nevada or Utah be subsidizing small business people in New York or the District of Columbia? Or should the State of New York be doing that or the District of Columbia per se, which is an interest question which we'll have to consider too.

You mentioned that the State of New York is hardpressed. Senator Riegle, my distinguished colleague, as ranking member, if he were here he would point out that the State of Michigan temporarily is even more hardpressed. In fact you would begin to get a chorus around this subcommittee with persons telling how their legislatures are even more embattled than the last story you heard.

So I think we have a depressing problem here as to what is equitable even if we have a need for a safety net of sorts. Although I appreciate your being forthcoming and from your experience, of course, you have a great deal to say.

Mr. **Nutter**. Mr. Chairman, I think perhaps some clarification is in order. When all of us talk about these programs the tendency is to make statements which may seem applicable to both the riot reinsurance program and the crime insurance program. I think this clarification may be appropriate. That clarification is that the riot reinsurance coverage is not of the crime insurance policies that are issued. What you are talking about here are insurance companies which may buy reinsurance from the Federal Government for a variety of lines of insurance. Insurers in New York cannot purchase the Federal riot reinsurance coverage because New York has not qualified. Neither has Florida as we discussed earlier with Mr. Fritzel.

QUALIFICATIONS

Senator **Lugar**. What do you mean by not qualified?

Mr. **Nutter**. They have not met the qualifications under their FAIR plan in the State to make insurers in that State eligible to purchase the Federal riot reinsurance coverage and, to the best of my knowledge, they never have.

Mr. **Hunter**. They have. They no longer meet the requirement to have consumer members on the board.

Mr. **Nutter**. I think it is also important to reiterate a change in the law since these programs were created. The riot reinsurance program really was a catalyst, an inducement for the insurers to work with the States to create FAIR plans, to make essential insurance available to consumers, to the general public. Since that time most of the States which created those FAIR plans have severed the legal tie between the FAIR plans and the need for the existence of the riot reinsurance program. The FAIR plans in all but three States are free standing of the Federal riot reinsurance program. They will continue in existence whether or not the Federal riot reinsurance program is terminated. Those plans will continue to provide essential insurance to the general public in those States that they are available.

I think essentially what you have here is a statement on behalf of those who support the continuation of the riot reinsurance program that they are looking for a guarantee of a future market. They are currently relying upon the private market. A statement was made that by and large smaller companies are buying Federal riot reinsurance coverage. The fact is that of the premiums paid for this contract year nearly half, or more than half, of the premiums, paid are from two insurance companies—the Liberty Mutual Insurance Group and the General Accident, which are probably in the top 20 or 25 insurance companies in the United States. Beyond that, you have 34 company groups which indeed are small companies. I would question how many of those want out of the program if in fact they knew the availability in the private market.

Senator **Lugar**. Just as a matter of curiosity, why do these large firms continue to participate? Why do they buy this?

Mr. **Nutter**. I am probably not the right one to ask because I don't represent those companies, but I do think there's been some indication—and Mr. Bragg knows better than I to speak of that—of whether any of those companies have, after signing the contracts for the current contract year, any interest in terminating those contracts. The fact is, as Mr. Bragg has testified, the premium once paid, the contract once signed, is considered fully earned and his hands are tied about a premium refund. But I think you will find that if the program is continued one more year that the number of companies will drop again very dramatically.

You spoke earlier about the condition of the society and the economic times. Again, keep in mind that the Federal riot reinsurance program is not the principal source of riot reinsurance coverage in this country. It is the private market and those private reinsurers have made the assessment of the short and the long term exposure that they have and they've made the commitment to continue that.

Senator **Lugar**. Do any of you gentlemen——

Mr. **Hunter**. Yet in your statement, Mr. Nutter, you concluded by saying it's impossible to guarantee unlimited capacity or state unequivocably that future availability will always be adequate in the private market, and that's the issue that I think Mr. Bernstein and I have raised. If riots occur, we're going to be faced with a terrible situation. We'll be back into the late 1960's and we just do not think it's appropriate to terminate it. Insurers can, at their option, decide not to purchase Federal riot reinsurance as 200 of the 300 or so did and they continue to have that option.

Mr. **Nutter**. Mr. Chairman, excuse me for responding, but if I may take 1 more minute, I think what Mr. Hunter and Mr. Bernstein are relating to is the rate, not the availability, if the private reinsurance market experiences severe losses, if their contracts incur liabilities as indeed they will, then the rates will be adjusted to reflect that experience. What Mr. Bernstein and Mr. Hunter were talking about is the availability of Federal riot reinsurance at an inexpensive rate, at a rate which does not necessarily reflect what the future losses may be. The question before the Congress I think is, whether or not the Federal riot reinsurance is making essential insurance available in States. The answer is, it is not. FAIR plans are freestanding from the Federal riot reinsurance program and they will continue to provide essential insurance in these areas where FAIR plans exist.

Senator **Lugar**. Mr. Bernstein.

AFFORDABILITY

Mr. **Bernstein**. One, there's no question that there is availability today and there is a price. The price as well as the availability comes at a time when by every standard this is the most competitive commercial and personal lines market. Companies are competing in a very soft market to the extent of having losses at a combined ratio of over 100 percent, in effect, living off their investment income to break even. That could dry up like this. Industry people are predicting catastrophe regardless of riots. When that market starts to go back to normal—we don't know what the situation will be. We're not saying today there is no market. Our companies, the companies that I represent are not buying the insurance. They're saying that a 25 cents rate is excessive. Obviously they're not going to pay 25 cents for something that has made $120 million at a 2.5-cent rate. We've paid it and the money goes to the Government, but we're saying we want that security.

The second point I'd like to make is what is that security. The security is not just the continuation of FAIR plans at the State level. FAIR plans are a residual market. FAIR plans represent that business that companies have made an underwriting judgment on in saying those risks are not good enough to be written in our voluntary market.

Now what goes into that judgment? A number of things, including overall profitability. To the extent that companies feel secure in having a backup against catastrophic losses, they are more likely to write more business voluntarily and put less business in the FAIR plans and to the extent anyone wishes less business to be written in the involuntary market, the more important it is to encourage that security that the Federal riot reinsurance has encouraged over the years. There will always be residual markets, but the size of those residual markets, the FAIR plans in this particular case, will increase or decrease tremendously depending upon the security of those companies in knowing they've got that.

What our companies urge is, to the extent the Federal riot reinsurance program doesn't cost the Federal Government a cent, keep it on the books, keep it ready for the next disaster if it comes. If it doesn't come, then nobody will buy the insurance.

I know when I was in FIA we ran that program with three people. I don't know how many people are running it today. It's a self-executing program that is simple and cheap. I think total expenses of that program since inception were something like $4 million. Total losses were about $20 million.

Mr. NUTTER. Mr. Chairman, it sounds like a debate between Mr. Bernstein and I, and I apologize to you for that. The Federal Insurance Administration has filed with the President of the Senate and the Speaker of the House a liquidation report for the crime and the riot reinsurance programs. Notwithstanding that this riot reinsurance program has not cost the Government a penny in these intervening years, that liquidation report indicates that they have claims pending in the riot reinsurance program which will indeed require them to borrow funds from in the Treasury which will in fact require them in time to repay that and will require appropriations.

Mr. BERNSTEIN. Those obligations are on the book whether you end the program or not, but what should be pointed out is the reason they have to borrow is because they pay crime losses out of the riot program. There was $120 million plus of profit in the riot program. Only because those funds were used for other than riot programs does the liquidation report have to point out that borrowing has to be required. But that borrowing will have to be required on the basis of existing obligations which are independent of whatever the Congress does to end the program on September 30.

Senator LUGAR. I thank you gentlemen very much for coming. I thank the majority and minority staff for bringing you together. This was a stimulating panel at least for the benefit of the public. I hope likewise that you enjoyed it, too. The record will be made available to all Senators on the committee prior to our markup on these important programs. We appreciate your coming.

[Whereupon, at 11:55 a.m., the hearing was recessed, to be reconvened at 9:30 a.m., April 15, 1982.]

[The following material was ordered inserted in the record:]

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS,
Washington, D.C., April 20, 1982.

Attention: Laurie Sills.
Hon. ALFONSE D'AMATO,
U.S. Senate,
Washington, D.C.

DEAR SENATOR D'AMATO: Enclosed are our responses to three questions you submitted in writing for the Federal Insurance Administration hearing before the Housing and Urban Affairs Subcommittee on April 14, 1982.

We are pleased to respond to your questions and appreciate your concern about the future of the Federal Crime Insurance Program. It is hoped that our answers to your questions will help you in understanding our position on this program and why we believe it should and could be handled by state insurance authorities.

Sincerely yours,

CHARLES H. FRITZEL.

Your companies say that they are philosophically opposed to the Federal Crime Insurance program.

Question. Are your companies proposing to offer Crime Insurance in New York City at affordable rates?

Answer. As we stated in our testimony before the Housing and Urban Affairs Subcommittee, the Federal Crime Insurance program is not insurance. Insurance would have to be written at actuarially sound rates. Crime insurance rates are not actuarially sound. It amounts to a subsidy to businesses and residents of high crime areas. The private insurance industry could not provide this kind of subsidy to residents of New York City and we never have maintained we could or suggested that we could. Some of the current policyholders undoubtedly could be placed with private insurers. But most could not at a rate which results in a 3 to 1 loss ratio.

What NAII is suggesting is that this is a state problem. Nearly 60 percent of all federal crime insurance policies are written in New York City. We believe, and so stated in our testimony, that private insurers should work with the New York State insurance authorities in developing a state program to replace the federal one. States have created residual market mechanisms for high risk automobile drivers and homeowners whose property may be uninsurable at "affordable" rates. Basically, these pools require all insurers doing business in the state to take a percentage of these high risks in accordance with the amount of insurance they write in the state. Another way to develop a pool for paying crime insurance subsidies could be a special premium tax. NAII already has met with staff members of the New York State Legislature to discuss this problem, and we have enlisted the assistance of Federal Insurance Administrator Jeffrey Bragg in making available to the New York authorities the federal government's experience with the program as it affects New York.

Followup question. Then why are you opposing the Federal Crime Insurance Program?

Answer. NAII opposes the Federal Crime Insurance program because it is not national in scope (60 percent in New York and 75 percent in only four states) and is a problem which should be addressed by the states. As we said in our testimony, "Insurance is a state regulated business and because we believe in state regulation and because so much of the program is written in New York, we think it is better left to the state and insurers doing business there to solve this problem."

We also agree with the statement made in the Liquidation Plan for the National Insurance Development Program whch was forwarded to the President of the Senate on February 12, 1982, by Federal Insurance Administrator Bragg. It makes the following comments in regard to the impact on Federal Crime insureds should the program be ended:

"While there is evidence that some insureds would experience difficulty in being placed in the private market, there are states which have developed crime insurance programs of their own. Both Michigan and New Jersey have had programs created under state legislation which have been in existence since the initiation of the federal program and these programs represent one way of meeting the crime insurance availability problem. In addition, the states of Indiana and Wisconsin have less formal programs supervised by their Insurance Departments. Neither Indiana nor Michigan has been a Federal Crime Insurance Program state. Several FAIR Plans have followed the lead of Massachusetts in making limited amounts of crime insurance available through the offering of homeowners insurance policies. Rhode Island, Wisconsin, Michigan, Maryland and Illinois have added such coverages. In any event, the degree of a problem of crime insurance availability and/or affordability has not demonstrated that it is beyond the ability of the states or private insurers to develop means of addressing the situation."

The Washington Post recently wrote an article stating that one of your larger insurance companies (Allstate) would not be offering Crime Insurance in the District of Columbia unless the resident stayed at home all day, because the crime rate was too high.

Question. Would you please comment on this?

Answer. Enclosed are copies of two Washington Post articles regarding the Allstate Insurance Co. decision not to write renters' insurance in the District of Columbia unless someone is in the residence on a 24-hour a day basis.

First, let me say that I think there is a misunderstanding of terms here. The March 26, 1982 article describes a decision by Allstate not to write any additional renters' coverage. I emphasize renters'. Allstate continues to write regular homeowners' coverage for property owners which includes coverage for theft. The article also describes the policy of other insurance companies which do continue to write renters' coverages. We always have suggested that persons seeking insurance shop around for the best deal. Our industry is a highly competitive one. Renters' insurance is readily available at affordable rates from other insurers in the District of Columbia.

The second article from the Washington Post dated April 1, 1982, describes a meeting between Allstate Insurance officials and the Superintendent of Insurance for the District of Columbia. In that meeting, Allstate agreed to reconsider its decision on the 24-hour rule and to consider other options for renters' coverage. The meeting between Allstate and the Superintendent of Insurance is an excellent example of why NAII so strongly supports state insurance regulation. Here we have a case where the regulator is calling in the company in an effort to solve a problem.

[From the Washington Post, May 26, 1982]

ALLSTATE SETS 24-HOUR RULE ON D.C. RENTERS' POLICIES

(By Molly Sinclair)

Allstate Insurance Co., citing high theft losses and low ceilings on rates it can charge, is now refusing to write any new renters' policies in the District of Columbia unless the policyholder can guarantee someone will be home 24 hours a day.

District residents who already hold Allstate policies are not affected by the new requirement, which was adopted in November. But the company is turning down Allstate policyholders who move into the District and try to transfer their renters' coverage, as well as District residents applying for renters' coverage for the first time—unless they satisfy the 24-hour rule.

Allstate's action represents a departure from the way it typically operates in the rest of the country and contrasts with the practices of other major insurers, such as State Farm, Aetna, Geico and Fireman's Insurance Co. Spokesmen for those companies all expressed surprise at the Allstate move and said they are continuing to insure renters in the District regardless of whether they are at home round the clock.

James Montgomery, acting superintendent of the D.C. Department of Insurance, has expressed concern about possibly unfair discrimination against renters who work or attend school and therefore cannot qualify for Allstate coverage. He said he will meet with Allstate representatives Wednesday to discuss the 24-hour rule, which makes exceptions for things such as vacations and nights out but probibits coverage if the policyholder has regularly scheduled absences from the home during the day.

"Hopefully, I can work something out informally with the company that will be acceptable rather than take formal action," said Montogomery, who can impose a fine or revoke or suspend the license of a company found in violation of local insurance laws against discrimination.

Allstate said its rule is not discriminatory. "We are in full compliance with the law," said David Rowe, a spokensman for the company, which now insures an estimated 3,000 renters in the District. He said that the rule applies only to renters, not house or condominum owners, and that the company has no plans to expand the restriction at this time.

Rowe said that the company, one of the giants in the insurance industry, has lost money for two years on its D.C. renters' insurance, which covers loss or damage of personal possessions. "Our losses and expenses were such that we were spending $1.30 for every $1 of premium taken in," Rowe said.

Those losses, he said, reflected thefts from D.C. homes. Rowe said that national studies have indicated that the losses from property left unattended for long periods of time generally are greater than losses from property occupied 24 hours a day.

At one point Allstate filed a petition with the D.C. Insurance Department asking for a higher rate ceiling on renters' insurance, so that the company could adequately recover expenses and losses, Rowe said, but the request was denied. He said the only other alternative was for Allstate to limit its exposure to renters' theft losses by refusing to issue new policies to tenants who are not home all day.

Allstate and other insurers normally offer two different renters' policies at two different prices. Renters who have someone on the premises 24 hours a day typically are eligible for the company's standard, less-expensive policy. Those who are absent part of the day are offered the higher-risk policy, which may cost as much as 50 percent more than the standard coverage.

In Arlington, for example, the Allstate standard renters' one-year policy for contents worth $30,000 in a brick high-rise apartment sells for $106 while the Allstate Indemnity higher-risk policy for the same tenant would be $160.

But in the District, where the cap on renters' insurance for contents worth $30,000 is $107, Allstate traditionally has sold only the standard policy. Until November, when the rule changed, that policy was available to renters regardless of the number of hours they spent at home.

One 34-year-old woman who moved here recently from Memphis lost her Allstate policy because of the occupancy rule. She said she had been with Allstate for 10 years and had never filed a claim. But when she contacted the company about transferring her renters' policy to her new Chevy Chase apartment, she was turned down because of the 24-hour occupancy requirement.

The woman checked with several other companies and finally bought a tenant policy from one of them.

The other major insurers in the District, scratching their heads over Allstate's decision, say they intend to keep offering renters' insurance without the occupancy requirement.

Geico, for example, which has 4,252 renters' policies in force in the District, "will write almost any kind of policy as long as the property is in good shape and we don't have too much concentration in one area," according to company vice president August Alegi. As for Allstate's move, he said, "I really don't see their rationale."

Aetna, with 3,326 renters' and condominium contents' policies, does not have the 24-hour rule, said spokesman Bob Nolan.

State Farm, although it reports a near doubling of losses from tenant policyholder theft claims between 1979 and 1981 in D.C., says it has no such rule and no immediate plans to impose one.

"Cutting off new business is kind of an extreme step that we don't like to take unless we have to," said David Hurst, a company spokesman. "It would give our agents one less product to sell in the marketplace * * * and our loss experience isn't bad enough for us to do that."

[From the Washington Post, Apr. 1, 1982]

INSURANCE FIRM MAY EASE RULES

Two Allstate Insurance Co. executives agreed yesterday to consider relaxing the company's rule that new applicants for renters' insurance in the District of Columbia must have someone in their homes 24 hours a day.

The requirement was imposed last November, company officials said, because of high theft losses and low ceiling rates in the District.

James Montgomery, the D.C. insurance superintendent, met for two hours yesterday with the two Allstate executives, Frank R. Montgomery (no relation) and Gene E. Mulligan, who came from the company's headquarters in North Brook, Ill., to discuss the requirement. Superintendent Montgomery had requested the meeting after expressing concern that the rule might discriminate unfairly against renters who work or attend school and are gone from their homes during the day.

Existing Allstate policyholders in the District are not affected by the 24-hour requirement. It applies only to those seeking an Allstate renters' policy for the first time in the District of Columbia.

In adopting the rule, Allstate departed from the way it typically operates elsewhere and from the procedures of other major insurers such as State Farm, Geico and Aetna. The procedure normally is to offer insurance at regular rates to renters who have someone at home during the day and, in cases where they are not home, to issue the policy at a higher rate.

During the meeting, Superintendent Montgomery asked Allstate to consider introducing a policy with a larger theft-loss deduction—the threshold amount above which the company is responsible—and a lower premium. A second possibility, he said, would be for the company to accept other security measures, such as deadbolt locks or building security systems, in cases where the tenant's home was vacant during the daytime.

"They said they would give serious consideration to these options," Montgomery said. He said Allstate agreed to respond within 30 days.

FISCAL YEAR 1983 HUD AUTHORIZATIONS

THURSDAY, APRIL 15, 1982

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 10:30 a.m. in room 5302 of the Dirksen Senate Office Building, Senator Richard G. Lugar (chairman of the subcommittee) presiding.

Present: Senators Lugar, D'Amato, Dodd, and Dixon.

Senator LUGAR. This hearing of the Senate Housing Subcommittee is now called to order.

Today in this third day of hearings on the HUD authorizations we have four panels, the first panel is one addressing the questions of public housing; and then, second, we will have State and local governmental officials and their concerns; third, multifamily rehabilitation; and finally, housing organizations as they take a look at the whole spectrum of issues.

If I have the unanimous consent of my colleague, the distinguished Senator from Connecticut, the Chair would like to suggest the same general rule that we had yesterday, and that is that each witness summarize testimony and make comments that will last no more than 5 minutes, which is a rigorous discipline, but an important one, in fairness to all of the witnesses who are to appear today. And then Senators will question after each panel as long as they want to, to make certain that we have the full scope and understanding of the full papers that you have presented.

With unanimous consent, we will simply say at the outset that all of the prepared statements that each of you bring will be made a part of the record, and your summary comments will not preclude consideration of the entire material you have presented or other documents that you wish to introduce and make a part of the record today.

The first panel is Philip Abrams, Acting Assistant Secretary for Housing, Department of HUD; Melvin J. Adams, vice president for housing, National Association of Housing and Redevelopment Officials; and Howard McLean, executive director, Housing Authority of New Albany, Ind.

Senator Dodd, do you have an opening comment this morning?

Senator DODD. To follow your good recommendations and suggestions, Mr. Chairman, I will ask unanimous consent that my short opening comments be made a part of the record. And I would also like to ask, if I could, that a letter from the Governor of the State of Connecticut regarding S. 2171 which will be commented on today, legislation I have introduced, be incorporated in the record at this point, if that would be appropriate.

Senator LUGAR. It will be incorporated.

[The statement and letter referred to follow:]

STATEMENT OF SENATOR CHRISTOPHER J. DODD

RENTAL HOUSING PRODUCTION AND REHABILITATION ACT OF 1982

Senator DODD. Mr. Chairman we will be receiving testimony today on legislation I introduce to authorize the Secretary of Housing and Urban Development to provide assistance to State and local government to finance the rehabilitation and development of affordable multifamily rental housing. I believe that this program, in conjunction with either existing or modified program resources focused on the problem of housing affordability, represents an efficient and cost-effective means of continuing this Nation's commitment to addressing the housing needs of its citizens who are not being served by the private sector.

S. 2171 embodies certain important principles for the future of Federal housing policy. This initiative overcomes the budgetary criticism of the section 8 program. The Congress will regain annual control ~~over these~~ activities and will not incur the long-term obligations inherent in the current programs. Resources will be delivered more efficiently as a result of the separation of affordability and availability concerns. In addition, State and local officials will become an equal partner in the development process. This will insure better coordination and leverage of resources as well as highlight the inportance of local support in the planning and location of housing developments so as to spur neighborhood development and mitigate displacement. Most importantly, this proposal reaffirms the premise that the Government has an obligation to respond to the housing needs of all our citizens who are not being served or provided with decent, affordable housing opportunities by the private sector. This will be accomplished at the lowest possible cost in a manner which anticipates maximum participation by other governmental entities and the private sector.

Mr. Chairman, the purpose of this bill is to increase the Nation's stock of affordable rental and cooperative housing. State and local governments would make application for assistance to encourage the construction or rehabilitation of multifamily developments in areas found to be experiencing severe shortages of decent rental housing opportunities, as determined by objectively measurable indices. In conjunction with the private sector, these governmental entities would have broad flexibility in designing the type of program assistance necessary to respond to prevailing local housing market conditions. For example, the assistance could be utilized as a capital grant or loan, annual interest reduction payments, or other comparable means to reduce project debt service and thereby create affordable, marketable housing. In accordance with locally identified needs, funds could be directed for either new construction, substantial rehabilitation, or moderate rehabilitation.

The amount of assistance would be the least amount required to provide modestly designed housing in an area for families or individuals without other reasonable and affordable alternatives in the private market. In addition, the amount of assistance would be sufficient to provide affordable rents in at least 20 percent of the units. In any assisted development to families with incomes below 80 percent of area median income. A project selection priority is established for proposals which exceed this later requirement in terms of either the percentage or length of commitment to our lower income citizens.

The bill contains other selection criteria designed to assure that only feasible proposals which maximize the necessary Federal assistance will be selected, including the degree to which such assistance will be eventually repaid to the Federal Government. Although this is a highly targeted program, the Secretary of HUD is directed to make resources available in different geographic regions and in nonmetropolitan as well as urban areas.

If any conditions of this assistance are breached or the owner sells or converts the development during the term of assistance, the amount of Federal contribution must be repaid in full with accumulated interest. While the Secretary will continue to regulate rent levels as is the case in current assisted housing programs, a new feature has been added to expedite consideration of rent requests from private owners.

In conclusion, this proposal attempts to overcome the criticisms of current programs and incorporates, both in terms of philosophy and program design, many elements of other pending initiatives, such as housing block grants and the administration's recent request for a rental rehabilitation grant program. In conjunction with other ongoing and emergency initiatives, it is my hope that we can reaffirm a national housing policy during this session which is a comprehensive response to the shelter needs confronting the American people.

State of Commandments,
Executive Chambers,
Hartford, March 19, 1982.

Hon. Christopher J. Dodd,
Russell Senate Office Building,
Washington, D.C.

Dear Chris: I am writing to you to commend your efforts to provide assistance for the construction and rehabilitation of rental housing, and to express my support for S. 2171—The Rental Housing Production and Rehabilitation Act of 1982—which you have introduced.

In Connecticut, as in the nation, the housing industry as well as those who are in need of affordable, quality shelter are experiencing extreme difficulties. In our state, 1981 was the worst year for the construction of new homes since the Second World War. Virtually no new construction of rental housing was undertaken other than those units which received some form of state or federal assistance.

A few pertinent statistics point out the extreme severity of the situation. The average price of a new single family home varies from $142,000 in Stanford to $83,000 in Hartford to $73,300 in Bridgeport—all areas which are experiencing shortages of rental housing. In January of 1982, the interest rate on a fixed mortgage was 18.58% and 16–17% for adjustable rate mortgages. Vacancy rates in the state's rental markets are at historic lows ranging from 1.5% in the Bridgeport area to 1.1% in the New Haven and Danbury areas.

While these factors point to a situation that is causing severe hardship for many, it causes particular problems for moderate and low income families who are in need of affordable, quality rental housing. Extremely low vacancy rates and a high level of conversion of rental units to condominiums not only limit the choices available to those persons in the rental market, but also drive up the rent for those units that remain in the supply.

The extent of this problem in Connecticut is illustrated by the fact that a high percentage of the recipients of certificates for the Section 8 Existing Housing Program are unsuccessful in their search for affordable rental housing and are forced to relinquish their certificates. In such a situation, a limited income supplement programs for housing, or voucher program, is not likely to be of assistance, and in fact may be counterproductive. What we need is an increase in the supply of rental housing.

I am very supportive of the strong role that S. 2171 provides for state and local governments in this effort. The bill provides the flexibility which we need to tailor the assistance program to address circumstances contributing to the shortage of rental housing in a particular market. It targets assistance to those most in need, and it matches this assistance to state and local housing programs.

Again, I commend your concern and action on this vital issue and urge the prompt enactment of S. 2171.

Sincerely,

WILLIAM A. O'NEILL, *Governor.*

Senator LUGAR. And now we will proceed in the order that we have announced their names, Mr. Abrams, Mr. Adams, Mr. McLean.

STATEMENT OF PHILIP ABRAMS, ACTING ASSISTANT SECRETARY FOR HOUSING, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Senator LUGAR. Thank you, Mr. Abrams. I know it is a busy day in your life and in the life of the Department.

Mr. ABRAMS. It is important to the Department that we participate in these hearings and that there is a complete understanding between the way the Department is proceeding and the way the Congress understands that the programs have been enacted, and we are eager to participate in panels like this one. It is a busy day. The Secretary thought this has a higher priority than some of the other goings on at HUD, and so I am happy to be here with you.

We have a statement for the record which I would request that you accept, and I will summarize it briefly.

Senator LUGAR. It will be placed in full in the record.

[The complete statement follows:]

STATEMENT OF PHILIP ABRAMS, GENERAL DEPUTY ASSISTANT SECRETARY FOR HOUSING—FHA COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

I appreciate this opportunity to speak with you about a program of vital concern to this committee, to HUD, and to low-income Americans—the public housing program. The public housing program is one of the oldest Federal assistance programs, having been initiated in 1937. It is also one of the most important, housing over three and one half million Americans in more than one million units across the country.

Most residents of public housing are low-income and almost one-fourth are elderly. However, as the program has grown, so have both its budget and its problems. In just the past ten years the operating subsidies for public housing have increased from $102.8 million to more than $1 billion. At the same time, the public housing stock has grown older and in need of more frequent and more costly repairs and, of course, energy costs have skyrocketed. We have also seen, throughout the sixties and seventies, that simply making units available to families, without regard to location, density and such, does not always result in decent, safe, and sanitary housing, or a suitable environment for family living.

In attempting to solve the nation's housing problems from Washington, the Federal Government has created a program with minimal local control and decisionmaking and with a budget that is escalating almost beyond control. It is time to make an evaluation of the public housing program and to recommend the changes needed to make the program work in the best possible way. We at HUD are trying to do just that.

We are reviewing and re-writing the regulations for the public housing program. This has involved the drafting of a single consolidated regulation covering the developing and management of public housing. In developing the revised regulation we will be substantially reducing the requirements made of Public Housing Authorities and local governments by giving them maximum discretion for program management. The remaining requirements are those required by statute or for sound program management. We expect the regulations to be available for Congressional review shortly.

PUBLIC HOUSING STUDIES

Over the past several months, the President's Commission on Housing, the National Association of Housing and Redevelopment Officials and others have proposed changes in the way public housing is operated. Given the proposals and the urgency of developing a long-range and comprehensive strategy for dealing with the program, the Department has undertaken a major review of policy options for public housing, to be completed in time for budget planning for fiscal year 1984.

The Office of Policy Development and Research, in consultation with the Office of Housing and the Headquarters Housing Operations Task Force chaired by the Under Secretary, has responsibility for the basic information collection and analysis required for this review. It will assess the feasibility, possible consequences, ease and speed of implementation, and cost benefits of a range of alternatives with respect to public housing. These range from simple modifications within the existing program framework to various levels of deregulation and greatly increased local control and discretion. they will be elevated in light of the objectives of controlling Federal expenditures and meeting the needs of those who are presently served by the program.

Information is being collected from multiple sources including HUD data collection forms, HUD Area Offices and consolidated data systems, local officials, PHA executive directors and staff, and local private housing market specialists. The effort includes site visits by a team of HUD staff to 26 Public Housing Agencies to collect information on approximately 450 projects within those PHAs.

The Agencies which have been selected for these site visits all have project-based budgeting—an important element in assessing program operations. Authority-wide information on PHAs without project-based budgeting is being collected through the Department's normal data systems. through the site visits we hope to get much better information than we now have on the benefits and disadvantages of various proposals, and on how such proposals might affect different kinds of authorities.

We are also about to complete an analysis of the Performance Funding System, and will forward to the Congress a study in which we outline possible options to the current system, with a detailed analysis of each. The paper will provide the kind of detail necessary for thoughtful decision-making regarding changes in the current system.

CONTROLLING COSTS

Few would disagree that the spiraling costs of the public housing program demand quick, decisive action before they become completely unmanageable. This Administration is moving to do something about the problem immediately.

We believe that concentrating our efforts and resources on the existing stock is the most economical and sensible approach. It will help to ensure that projects to which we have already made substantial commitments will remain economically viable and in good condition. Thus, we have proposed that the Public Housing Development program not be funded, that Public Housing Authorities be given the option of cancelling outstanding reservations for new construction and use a portion of the balance for the modernization of existing projects. We believe this approach, combined with the Comprehensive Improvement Assistance Program, which I will discuss in a minute, will allow Public Housing Authorities the flexibility they need to best meet their needs.

We have proposed a fiscal year 1983 funding level for the Comprehensive Improvement Assistance, or Modernization Program, at $1.8 billion. Through this program we fund substantial rehabilitation efforts as well as the upgrading of the management and operation of projects. Public Housing Authorities find this approach more satisfactory than HUD's earlier piecemeal approach.

Under simplified regulations and procedures, the CIAP program will enable PHAs to undertake comprehensive assessments of both their physical and management needs and to develop a five-year plan for dealing with those needs. An additional cost-cutting procedure is elimination of the program of federalization of state-operated public housing.

We have proposed a mandatory reduction in the allowable utilities expense level, recognizing that one of the deficiencies of the PFS is that fixed-base period consumption allowances do not reflect reductions which have occurred in PHA utility utilization.

A recent survey of the consumption of 17 major PHAs indicated a weighted average reduction of 10 percent as compared with the base period. A failure to take this into account by reducing the expense level would actually mean that the Department is paying some PHAs more than the operating subsidy needed for this purpose.

Also, the language of the House Appropriations Committee, in its report covering the 1981 Supplemental Appropriations and Recissions Act, directed the Department to take action to limit operating subsidy payments. It rather clearly sets forth the view that the Department's regulatory approach on utility consumption has been deficient and that special attention must be given to consumption reduction.

It is our position that PHAs should be required to conserve energy in amounts comparable to the savings effected by the private sector in the area in which the PHA is located. Allowances for consumption levels would also be reduced to reflect the benefits of all modernization/CIAP funds used for energy conservation.

In our view, a regulatory change is not needed in order to implement a mandatory reduction of the Allowance Utilities Consumption Level (AUCL). This opinion is based on the following language of 24 CFR 890.113(c):

"*Availability of funds.* In the event that insufficient funds are available to make payments approvable under PFS for operating subsidy payable by HUD, HUD shall have complete discretion to revise, on a prorata basis or other basis established by HUD, the amounts of operating subsidy to be paid to PHAs."

PUBLIC HOUSING OPERATING SUBSIDIES

For fiscal year 1983, the Department is requesting $1,075 million for Public Housing Operating Subsidies. This request reflects savings of an estimated $233.7 million below what would have been needed based solely on the funding levels approved for fiscal year 1982, the completion of an addition 38,000 units under management, and anticipated inflation between 1982 and 1983. The projected savings come about from three sources: First, we anticipate an additional $151 million in rental income because of changes in the way tenant rents are calculated. As a result of last year's legislation, we will be raising the rents of existing tenants to 27 percent of income as part of the gradual increase in contribution rate from 25 percent to 30 percent of adjusted income over a 5-year period. We also will be charging new tenants a full 30 percent of income at time of initial occupancy. The Budget assumes enactment of legislation authorizing the Department to count the value of Food Stamps in determining total family income, and in order to accommodate this change, we are also proposing to raise the current ceiling on annual rent increases from 10 percent to 20 percent.

We further anticipate a savings of $51.6 million from increased support of State and local governments. Our Budget assumes at least some minimum level of support for all PHA operating budgets. Finally, the Budget assumes a savings of $31.1 million from reduced energy consumption both on the basis of private housing experience as well as the impact of energy-related Modernization funding since 1975, and from cost reductions due to HUD deregulation.

We are nearing completion of the study of alternative mechanisms for calculating and allocating operating subsidies mandated by the Housing and Community Development Act of 1981, and expect to be able to share the results of our findings shortly.

In sum, we feel that the program changes we are proposing this year, combined with stress on improved efficiency and management on the part of public housing authorities, will improve life for thousands of low-income Americans while expending fewer tax-payer dollars. We welcome the interest and support of this subcommittee in this difficult and important task.

Mr. **Abrams**. The administration has been, since Secretary Pierce has come to HUD and the rest of us have joined him, concerned about the whole problem of public housing, particularly with various perceptions about what the problems are. And although we have not come to conclusions about what the future should be for public housing, we have come to some conclusions about and have enacted some administration policies that reflect our conclusions as far as what we think have been the problems in the past.

Obviously, operating subsidies have risen dramatically from a very low level just 10 years ago until more than $1 billion in fiscal 1982. Furthermore, public housing has an adverse image that in the media, due to the concentrated attention that some housing authorities get to the detriment of the majority of the housing authorities which are well run and provide a sound, basic housing program for low-income families.

DEREGULATION

We would like to address and remove that adverse image by evaluating the public housing program by deregulating, and we have in clearance at HUD regulations that do deregulate all of the various rules applying to public housing. The comprehensive systems improvement program regulations are at the final stages of clearance and will be coming to you for review before publication, as well as revised regulations on lease and grievance procedures, utility allowances and the complete rewrite of all public housing management with the stated intention of allowing as much latitude for management by the housing authorities and as much participation by local governments as possible.

For the future, we look at the recommendations from the President's Commission on Housing which include some innovative ways of approaching public housing. The NAHRO proposals, the public housing authority proposals, as well as the intensive studies that are being done by our own office of policy development and research, and particularly that study on the performance funding system which is in the final stages of clearance and will be forwarded to you shortly. We hope it will give us the basis for coming up with a fiscal program for the future of public housing, as well as new ideas regarding the determination of operating subsidies, if not for fiscal 1983, then most certainly by fiscal 1984.

Some of the conclusions that we have reached and we are either implementing or have submitted to you in the rescission budget or in the legislative packages involve a decision to—by the administration to ask your concurrence in using certificates or modified section 8 existing certificates as the main source for providing for the affordability problem of low income families. And in accordance with that, we have asked for rescission of public housing development funds and for no further public housing development funds.

We would like to work with what we have to maintain the public housing stock, to bring it up to safe and decent and energy conservation standards, and concentrate our efforts on what funds are available to serve that end. We think that is the prudent way to proceed.

UTILITIES REGULATION CHANGES

On the other hand, we have also implemented in our regulations two controversial changes to the regulation that involve utilities. The first change is somewhat in reaction to the House Appropriations Committee conference report in the June 1981 rescission bill, telling us that they believe that the Department should take steps to adjust the way energy consumption figures were monitored and provided for under the performance funding system, as well as instructions that came with language from the Office of Management and Budget in apportioning the appropriation bill funds to us.

We have taken two steps. First of all, we are reducing the allowable utility expense level that each public housing authority operates on which is a rolling base that starts in 1973 through 1976. We are reducing the consumption level of 1973 through 1976 by an amount that will be commensurate with reductions in the private sector markets in the communities that the housing authority is located in.

We believe that housing authorities and the tenants in housing authorities should make the same kinds of sacrifices and the same kinds of adjustments in living style that other Americans have made, because of the changes in the cost of energy and the impact that rising oil, gas and other energy costs have had on all Americans.

The second thing we have done is to ask for a payback on the amount of funds that have actually been expended to modernize housing authorities with federal funds to conserve energy. So, to the extent that a housing authority has received Federal funds and spent them to either put in a new boiler or insulation or storm windows, we are asking that the consumption level be reduced by a commensurate amount to reflect that Federal investment in energy conservation.

Those two items are obviously controversial, and they are a source of disagreement among many of the parties who have an interest in operating subsidies, but we believe they are necessary if we are going to bring the cost of this program under control. The operating subsidies for 1983 are requested at a level of $1,075 million. They are based on the legislative proposals made by the administration and, in the case of food stamps, by the Department of Agriculture. Obviously, any changes in those assumptions would require a reassessment of the operating subsidies that are necessary. But we think it is a sufficient amount of money, and if the housing authorities work with us to improve their management, if we can further refine the methods for distributing the funds so that they get to the housing authorities that need them.

In the short term, before we come up with a complete revision of the performance funding system, the $1,075 million in 1983, like the $1,152 million in 1982 will allow a well-run housing authority that is properly managed and that conserves energy, to be funded at 100 percent of its expense level. Other housing authorities who are not going to be able to meet that standard, are going to get less than 100 percent of funding requirements. On the whole, that is our short-term approach to public housing. It is a program that we would like to see improved through better management, through better cooperation between the housing authorities and HUD and which we are fully committed to working on to make, in the long run, drastic changes as agreed upon by local governments, the housing authorities and HUD in the best interests of the tenants in public housing.

Senator **Lugar**. Thank you, Mr. Abrams.

Our next witness, Mr. Melvin J. Adams, who in addition to being vice president for NAHRO's housing, is director of Dade County and has long experience in these areas. It is great to have you again this morning.

STATEMENT OF MELVIN J. ADAMS, VICE PRESIDENT FOR HOUSING, NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS

Mr. **Adams**. Thank you, Senator.

As you said, I appreciate the opportunity of introducing the NAHRO statement into the record, and I will summarize it.

[The complete statement follows:]

NAHRO

Serving the Nation's Housing and Community Development Needs

Statement of

Melvin J. Adams, Vice-President for Housing

of the

National Association of Housing and Redevelopment Officials

Before the

Subcommittee on Housing and Urban Affairs
Committee on Banking, Housing and Urban Affairs

U.S. Senate
April 15, 1982

National Association of Housing and Redevelopment Officials
2600 Virginia Avenue, Northwest Suite 404 Washington, D.C.20037 (202) 333-2020

Mr. Chairman and members of the Committee, I am Melvin J. Adams, NAHRO's Vice-President for Housing, and Director of the Dade County, Florida Department of Housing and Urban Development.

NAHRO, as you know, is a 48-year old Association of professionals who administer low-income housing, rehabilitation, and community development programs in localities across the country. We represent over 6000 individuals and 2000 agencies involved in carrying out these programs. I appreciate the opportunity to appear before you today to comment on the Administration's housing and community development proposals and to outline NAHRO's positions on what we believe to be the critical issues facing this nation in the areas of housing and community development.

Mr. Chairman, my statement will be divided into six parts:

- First, I would like to present NAHRO's general reaction to the Administration fiscal year 1983 budget proposals for housing and community development, and comment on certain HUD practices and policies which we believe raise serious questions about this Administration's commitment to the successful management of our low-income housing resources and to the people they serve.
- Second, I would like to comment on the Administration's approach to the Community Development Block Grant, the Urban Development Action Grant, and other community development programs.
- Third, I would like to state NAHRO's view on the case for continued production of federally assisted low income rental housing.
- Fourth, I want to address the Administration's main legislative initiatives and state our views on them.
- Fifth, I would like to call the Committee's attention to what NAHRO believes are serious issues relating to the preservation of existing low income rental housing stock.

- Sixth, and most important, Mr. Chairman, we want to discuss with you what NAHRO believes to be the most urgent problem facing those of us who are committed to housing low income Americans: providing adequate and predictable levels of operating subsidy to public housing authorities. NAHRO believes this problem demands immediate attention and we have a proposal to deal with it.

I. OVERVIEW OF THE FY83 HUD BUDGET PROPOSAL

Mr. Chairman, let me begin by saying that the first full budget of the Reagan Administration reflects not only an intent to curtail spending for housing and community development for the short run, it also signals a long range plan to sharply change both the nature and the dimension of this assistance.

The actual HUD outlays for fiscal year 1983 are estimated at only 10 percent less than in the current fiscal year--$13.1 billion in contrast to $14.6 billion. But outlays are only the end result of earlier allocations of budget commitments--the real story is in the request for budget authority. The depth of the curtailment in HUD's activity is starkly clear in the budget authority numbers: a reduction from $33.4 billion in 1981 to $13.1 billion in 1982 to $684.7 million in fiscal year 1983--a total 3-year reduction of 98 percent.

The proposed 1983 HUD budget virtually dismantles all of the Department's programs for new construction of assisted housing for lower income families. It holds at current levels the budget for HUD's Community Development Block Grant (CDBG) and Urban Development Action Grant (UDAG) programs, pending a potential turnback to the states of these programs in fiscal year 1984. It cuts back the level and scope of activity for the mortgage insurance programs of the Federal Housing Administration (FHA). For on-going operating programs, such as public housing, Section 8 and other assisted housing, the budget seriously curtails federal operating assistance. Some existing units would be sold or demolished with no replacement. Eleven HUD programs are not just curtailed; they are eliminated:

1. Section 8 new construction and substantial rehabilitation;
2. public housing new construction;
3. regular Section 8 tandem under GNMA;
4. targeted tandem assistance under GNMA;
5. housing counseling grants (although HUD will continue to certify or recertify counseling agencies);
6. Section 8 moderate rehabilitation;
7. Section 701 comprehensive planning grants;
8. Section 312 rehabilitation loans;
9. Neighborhood Self-Help Development Grants;
10. Section 108 CDBG Loan Guarantees;
11. Solar Energy and Conservation Bank.

The level of authorization for policy development and research activity is cut in half from fiscal year 1981. Given the kind and extent of the reductions in the proposed HUD budget for FY1983 and the alternatives proposed, the future mission of the Department, and indeed the federal government itself, as a major actor in housing and community development is cast into doubt. A detailed analysis of the Administration's proposed FY83 budget for the Department of Housing and Urban Development is attached to our testimony.

Two alarming trends are manifested in this Administration's behavior toward housing and community development programs. One is the trend toward devolution of responsibilities to states and localities that are increasingly experiencing fiscal distress themselves and hence are unable to cope with new responsibilities. The other trend is one of federal disengagement from a forty year involvement in the production of housing for low and moderate income families, in favor of a "free market" approach which seems oblivious both to the current economic paralysis affecting the housing industry and to the private sector's current and historical inability to provide for the shelter needs of our poorest families without appropriate subsidy or incentives.

There is another related aspect of the Administration's attitude that we find particularly frustrating, Mr. Chairman. That is HUD's approach to the problems of adminstering low income housing assistance programs. We cannot guage whether it flows from certain deep convictions about assisted housing held by this Administration or whether it simply is the product of piecemeal, erratic and short-sighted policy formulation and implementation. In any case, it hurts. It hurts because it deals with a subject we at NAHRO care greatly about. That subject is good management, and this implies good management by both the federal and local partners.

PHA administrators are good managers but we must have the resources to manage and a stable environment in which to operate. I would like to give you a few examples of the policies that cause chaos and instability at the local level with the hope that your Committee will encourage HUD to end its own unpredictable and "bad" management of PHAs:

- PHAs received only 85.5% of operating subsidy eligibility in FY81, yet the Administration refused to support the request for supplemental funding;
- After Congressional action in December, appropriating funds for an FY81 supplemental, it was not until three months later that HUD authorized its field offices to begin the distribution of these supplemental funds. To date, most agencies have not yet received funds which are only sufficient to take them to 96.5% of their eligibility for FY1981.

- In addition to the delay, HUD arbitrarily and unilaterally imposed a condition on payment to PHAs of the FY81 supplemental monies, requiring that PHAs acknowledge that the funding is in full settlement of FY81 costs (despite HUD's acknowledgement that it was only funding 96.5%), including utility adjustments which HUD regulations provide should be funded out of the next year's (FY82) funds.
- Three months after fiscal year 1982 has begun for over 40% of PHAs, HUD issued instructions for interim funding based on 75% of the PHAs' 1981 eligibility.
- Over six months after the beginning of federal fiscal year 1982, HUD is contemplating unilaterally changing the allocation system by modifying the Performance Funding System and making such changes retroactive.
- Over six months after receiving a request from the Congress, HUD issued a letter attempting to show the FY82 operating subsidy needs at $1.152 billion, when the Congress, a good number of HUD staff, and all PHA administrators know that that figure is substantially under the real need for this fiscal year.
- Within two months of Congressional funding of FY82, HUD submitted a series of rescission requests effectively designed to destroy any progress made in housing low income persons.
- HUD, without following the rule-making procedure, attempted to change the policy governing total development cost limitations for new public housing. This action effectively reneges on agreements between HUD and localities, PHAs and citizens, and PHAs and developers.
- HUD is attempting to mandate an artificial utility adjustment factor for PHAs without following rule-making procedures and with no attempt to justify the validity of such a factor.

- HUD has not issued regulations implementing the Omnibus Budget and Reconciliation Act of 1981, thereby creating confusion in the administration of the public housing program.
- HUD Central Office has effectively stopped HUD participation, including Area Office staff, in conferences and workshops conducted by and for housing program administrators.

In addition to these administrative problems, the Administration's legislative proposals threaten the stability of the program and particularly our ability to house low income persons. It is apparent that a number of Administration proposals are being made without considering the combined impact on both the income of the tenants and the operating income available to assisted housing programs. These proposals are made at a time when cutbacks are being made in programs of employment assistance, health care, nutrition and social services, and against a backdrop of unemployment which is at a 40-year high in many parts of the country.

The Administration's new proposals I refer to include:

- including food stamps as income in determining rent levels in housing programs;
- considering the value of housing assistance in computing levels of welfare assistance;
- eliminating all deduction from income in calculating rents;
- modifying last year's legislation to permit rent increases of up to 20% per year;

Mr. Chairman, I have said all of this to say that the agenda and direction HUD is following is most distressing. We are dedicated to the continuation of assisted housing in general and conventional public housing in particular.

We believe it can continue to work if it is adequately funded, if we have incentives in our operations, and if we can eliminate the unstable and chaotic operating environment I have described above. Before discussing NAHRO's proposal for dealing with these problems, I would like to comment on the Administration's approach to community development programs.

II. COMMUNITY DEVELOPMENT

Mr. Chairman, NAHRO strongly supports funding the Community Development Block Grant and UDAG programs at the levels authorized through last year's legislation: $3.66 billion for CDBG and $500 million for UDAG.

The current year's appropriation level ($3.456 billion and $440 million respectively) actually reflects a reduction in activity due first to the inflation in costs; second, in the case of CDBG, to the expanded program eligibility of additional communities and the new split in final allocations using a 70-30 split for entitlement and non-entitlement (small city) categories. CDBG entitlement cities are estimated to grow from 669 to 732 between 1981 and 1982. The impact of all of these changes is a likely reduction in CDBG grants to entitlement communities from 10 to 17 percent. Also hanging over both CDBG and UDAG is the transfer to the states of the administration of small city CDBG programs and the announced intention of the Reagan Administration to transfer these two programs in total to the states in fiscal year 1984 as part of the program of "New Federalism".

Related programs such as those of EDA and the Small Business Administration and others have been slashed so dramatically that the overall reduction in community and economic development resources available to localities in 1982 was in excess of 50%. If one adds the impact of inflation, the actual reduction is even more devastating.

It is foolish to speak of economic recovery and revitalization and then deny resources to state and local governments to provide the basic infrastructure and incentives to make that recovery possible.

In light of the cuts visited upon community and economic development programs last year, anything less than the authorized levels for CDBG and UDAG would be unacceptable.

NAHRO, the U.S. Conference of Mayors, the National League of Cities, the National Association of Counties and the National Community Development Association have conducted a survey of cities and counties to determine the accomplishments of the CDBG and UDAG programs and the impact of the actual and proposed funding cuts on program progress and activities. The results of that survey are currently being analyzed and will be submitted to the Committee in the near future. Preliminary data shows that local communities have had to defer projects which would improve public health and safety as a result of the cuts. Rehabilitation of substandard housing units has been slowed. But, perhaps the most devastating impact this Administration's proposals will have on our cities' and counties' revitalization and development efforts will be to watch millions of dollars already invested by communities go to waste. This is because local governments have committed millions of dollars in activities such as land acquisition, site clearance and improvements, and other activities necessary to package parcels of land for development. We can cite projects, many in your own states, that have committed CDBG funds for such activities on the expectation of receiving assisted housing funds from HUD. These activities funded under the CDBG program are so closely related to local housing and development strategies that further reduction in CDBG funding and the proposed elimination of housing funding will have a shamefully negative impact on our existing investments.

NAHRO strongly opposes the Administration's intent to make no Section 108 loan guarantee commitments in FY83, and in fact, to curtail commitments in FY82. The Section 108 program has received accelerated use in recent years. Our members have found the Section 108 loan program to be particularly useful in financing acquisition and rehabilitation of local structures for use in housing or economic development projects. As you know, because the Section 108 loan program requires participating local governments to pledge their future CDBG monies as part of the loan security agreement, there is no additional cost to the government should the local government fail to retire the loan. Moreover, because of the burden of cost of forfeiting future CDBG funds, local communities will carefully weigh the risk involved in projects proposing to use the loan guarantee. NAHRO believes the Section 108 loan guarantee program represents an exemplary federal, local, private partnership. We need additional, not fewer, such tools.

III. HOUSING PRODUCTION

Mr. Chairman, the Administration proposes a greatly diminished federal role in housing. It would reduce long-term federal obligations for housing assistance payments on existing contracts, and it would eliminate any new obligations for future payments for any new units in the production pipeline which are not firmly under contract. In short, it seeks to curb to the maximum degree possible federal involvement in assisted housing. NAHRO strongly disagrees with this approach.

We believe that there is a continuing need for a program of assistance for new construction and substantial rehabilitation for low income families. This nation faces a rental housing crisis of unprecedented dimensions. Many areas of the country, urban and rural, have no adequate housing supply. The Administration's new housing initiative, which I will discuss in more detail later, does not address this problem. The Administration's proposals calls for a sharp change in both the nature and the dimension of federal housing assistance. In fact, the Administration's FY83 budget calls for no new construction or substantial rehabilitation program except for 10,000 Section 202 units for the elderly or handicapped. Thus, the Administration would terminate almost all construction of low income rental and public housing.

Yet the need for new and substantially rehabilitated rental housing units remains acute. Public housing authorities are still able to house only 13% of the qualified population. Waiting lists are extensive. Statistics from HUD's Annual Housing Survey show that as of 1978, over 7 million households are still housed in substandard or overcrowded conditions. As household formations, abandonments and conversions increase, the national rental vacancy rate has fallen well below 5% and in some individual markets, it is as low as one-half of 1 percent. The production of rental housing in the private market has virtually ceased. Short supply and low vacancy rates are putting tremendous inflationary pressures upon the existing housing stock. As moderate and middle income persons are finding it harder and harder to find affordable units, low income persons are being forced out of the market entirely.

Mr. Chairman, NAHRO urges this Committee to approve a comprehensive housing measure which includes assistance for new construction and substantial rehabilitation of housing for low income families of at least 24,000 units. We urge this upon you for two reasons:

- First, because over 7 million American households are living in substandard or overcrowded housing and/or paying more than they can afford for shelter;
- Second, given the state of the building industry, we believe that the public good can only be served by recognizing these unmet shelter needs and the benefit to our entire economy of addressing them.

IV. ADMINISTRATION LEGISLATIVE PROPOSALS

Modified Section 8 Certificates

The Section 8 program, as currently constituted, is a successful and effective program; the proposed changes, we believe, could have an adverse effect on the interest of the family, the landlord, and the administering agency. We support the continued requirement that units under this program must meet Housing Quality Standards. Beyond that, our concerns about the changes being proposed to the Section 8 existing housing program are as follows.

- Income Limits. The proposal to limit eligibility to families with incomes 50 percent of the area median income or below has problems. It eliminates from eligibility the "working family" with children, whose income falls between 50 percent and 80 percent of median income, and whose housing needs are at least as critical as those of non-working households with lower dollar incomes. Professor Michael Stegman of the University of North Carolina has documented this situation in an article in the December, 1981, issue of the Journal of Housing; we respectfully request that this article be included in the hearing record. Based on analysis in New York City, Professor Stegman found that Section 8 program participants with incomes between 50 and 80 percent of the median income were:
  --disproportionately minority (66 percent were black and 15 percent Hispanic)
  --more likely to be households with children (52 percent are one-parent households with children and 25 percent are households with two parents and children)

To deny such families eligibility for a Section 8 certificate would be to deny assistance to families with critical housing needs.

- Payment Standards. The modified certificate program establishes a new "standard" at a point below the currently-calculated Fair Market Rents, to govern federal assistance payments. This standard would be determined by the Secretary of HUD without any opportunity for public comment; he has indicated his intention to establish such a standard at 80 percent of the current Fair Market Rents. Federal assistance would be the difference between this "standard" rent and family rent payments based on 30 percent of adjusted family income; there would also be a minimum rent requirement. A family would be free to pay more or less than the "standard" rent; if more, the family would absorb the additional cost; if less, it would keep any difference. Also, the initially-calculated assistance to the family would be set for the term of the lease, even if the family moved to other housing. There would be no adjustment in the event of rent increases.

Mr. Chairman, this new "rent standard" policy would have serious impacts on the low-income family. While the justification is that it will give the family more freedom of choice in its housing, it could well result in a family stretching beyond its means for the only available standard housing in the local market; and having to absorb any increases in rent. NAHRO believes that the current Section 8 existing program and the Fair Market Rent system is a better way to assure equity for the family. While we recognize that not all assistance should gravitate to the level of the Fair Market Rent, we believe there are other remedies than the one proposed. One solution is to provide further leeway for the public agencies to negotiate rents with landlords; another is to refine the documentation for setting rent levels for standard, available housing in the community.

- Role of the Administering Agency. While it is not spelled out in the proposed legislation, the discussion surrounding its introduction indicates a desire for maximum "freedom" between the "family" and the "landlord" to implement a certificate program. This could result in administrative regulations which would deny families the assistance of the public agencies in locating housing, in overseeing the lease document, and in monitoring the family-landlord relationship over the lease term. Experience under the existing program indicates that there are important safeguards in the program for both the family and the landlord. We would caution against their elimination.
- Attractiveness to Landlords. Several proposed provisions of the new modified certificate program could significantly affect landlord interest in participating in the program. First, the reduced level of assistance payments based on the payment standard, and the "fixed" nature of this payment during the lease term, could raise questions about the family's ability to meet its rent obligations. Secondly, the provision (Section 202 a-5) which states that "no assistance payment shall be made for any unit after the month during which the unit was vacated" removes the security for the landlord currently provided in Section 8 (c)(4), which provides payment for up to 60 days after the unit is vacated. Finally, any reduction in the role of the administering public agency as described above, removes assistance available to resolve any problem areas in implementing the lease arrangement.
- Method of Budget Calculation. Another serious problem with the new proposal, from our viewpoint, is the change in method of federal funding in the HUD budget. Under the current system, budget authority for the Section 8 existing program is committed for the full term of the leases, not including the family rent contribution. This makes

possible the establishment of a reserve fund to take care of additional family assistance if rents should be increased. There is no such provision in the new proposal. Elimination of the reserve fund would not only work to the detriment of the family, but would also remove a basic factor in the stability and efficiency of the program.

Rental Rehabilitation Grants

Mr. Chairman, in as much as the rental rehabilitation initiatives proposal is based on a desirable objective--to help preserve the nation's rental housing stock in low and moderate income neighborhoods--NAHRO is pleased at the Administration's recognition of this need. We strongly feel, however, that the crisis in housing that our nation now faces will be little served by this program. New construction initiatives should be a much higher priority on our housing agenda--we have existing workable programs for rehabilitation whose major drawback these days is underfunding. The use of funds proposed for this rental rehabilitation grant should best be left to local determination in existing CDBG rehabilitation efforts. As described, this program would restrict local flexibility in designing rehabilitation programs which most economically suit local needs by forcing localities to come up with up to one-half of the costs of financing these units. We believe that the proposed new program gives too little and asks too much. It should in no case be considered as a major component of any housing bill.

V. PRESERVATION OF EXISTING STOCK

Public Housing Modernization

Mr. Chairman, ninety thousand units of desperately needed public housing are today falling into disrepair and vacancy. Another 100,000 units are drifting into that status, unavailable to the tens of thousands of Americans who cannot find affordable shelter. What is the Administration's response? While in both 1982 and 1983, budget authority for modernization of public housing is authorized at the level of current commitments--$1.8 billion in each year--it is authority proposed to be recaptured in its entirety from earlier authorizations. In 1982, $300 million of budget authority is deferred from 1981; $1 billion is from recaptures of public housing development funds; and $500 million is derived from public housing agencies accepting the HUD offer to use 50 percent of their reserved development authority for modernization. In 1983, the budget authority for modernization would come from two sources: $1.3 billion from public housing agencies opting to use their reserved development funds, and $500 million of recaptured development funds retained by HUD for public housing agencies who do not have funds to convert. Again, no new appropriation has been requested for modernization. Mr. Chairman, this approach is simply a shell game. It is a game with no winners: not the tax payers who have paid for our invaluable public housing asset; not the low-income elderly and the families who now live in public housing; not the low-income elderly and families who need public housing; not the construction industry which desperately needs work.

As you are aware, we manage a very valuable and often old capital asset. The Comprehensive Improvement Assistance Program is a well conceived and well designed program, Congressionally mandated with the intent of helping us to continue to maximize the use of this housing stock. We strongly urge you to give this program a chance to increase the usable stock by maintaining your original commitment to modernization through a separate and adequate appropriation.

In addition to the separate authorization for CIAP, NAHRO urges this Committee to adopt a provision similar to that approved by this Committee last summer permitting a public housing authority, at its option, after consultation with the local government and with HUD approval, to shift development funds to the Comprehensive Improvement Assistance Program.

Demolition

Mr. Chairman, NAHRO is supportive of maintaining the existing stock of conventional public housing and of improving it through the Comprehensive Improvement Assistance Program, if at all possible. Therefore, we urge the Committee to discourage any goal of demolishing that stock in 1982, 1983, or thereafter. If, and only if, units are found to be injurious to the health and safety of tenants either structurally or locationally and there is clear evidence that it is economically infeasible to rehabilitate them, can NAHRO support demolition. If these conditions exist, demolition must be at the local option of the authority and lost units must be replaced on a one-to-one basis over and above the 24,000 units of new production we feel necessary. Again, we are adamantly opposed to the demolition of usable public housing stock and can support demolition only if the above conditions are met.

VI. PUBLIC HOUSING OPERATING SUBSIDIES/NAHRO PROPOSAL

The Problem

As you know, Mr. Chairman, NAHRO members manage all types and sizes of housing authorities in every state of the Union. Because of the length of our institutional experience in dealing with public housing issues, and because of the depth of our members' involvement in operating public housing, we believe we can offer the Committee a unique national perspective on the critical choices Congress must make in dealing with public housing issues. We are talking now about $70 billion worth of public assets. These assets are devoted to the public purpose of sheltering over 3 million of the elderly, the handicapped and the poor.

Mr. Chairman, our situation with regard to operating assistance for public housing is desperate. In the first place, the level of federal operating assistance proposed in the FY83 Administration budget is incredibly below the inadequate 1982 level. It is estimated to meet only 77% of the projected need for this year. Clearly, proposed changes in income and rent determinations will not accommodate such a shortfall. Make no mistake, we are on the road to bankruptcy. Are we going to continue our 45 year commitment of providing decent, safe and sanitary housing for all Americans? Even in the best of economic times, the private sector has not been able to fulfill the housing needs of low and moderate income persons. Now, more than ever, adequate and reliable public funding is essential to support public housing.

What should be a well-managed enterprise supported by a realistic and reliable partnership of local and federal authorities, has turned into a guessing game. The result is inadequate and unpredictable funding levels, and no local recourse to resolve the problem. I will not repeat for you all of the statistics of the public housing crisis, with which you are familiar.

It is simply not possible for housing authorities to plan, budget or manage their activities competently in this current unstable environment. NAHRO believes that it is critical to revise the current public housing funding system in order to save public housing as a viable and stable housing resource for low income families. To accomplish this, NAHRO proposes a system which is based on three separate but integrally related elements. Each element is essential to the success of the program. Failure to adopt one will make the revised system inoperative.

The NAHRO Proposal

- The first element is to establish a different funding mechanism for public housing operations in order to overcome the devastating effect of the erratic funding we face now and have faced in the past few years. We recommend that the funding of public housing operating subsidies be modeled after programs such as the Section 8 existing program with contract authority provided for the first year, budget authority over a period of at least 3 years. Under this system, the Secretary would sign a contract with each housing authority and stability and predictability would become a part of the program. A new contract and funding would be required for new units in the inventory. We have kept the term of the commitment short, at only three years. NAHRO is proposing a stable, constant amount of funding for each of the three years, without indexing for inflation or other cost increases, provided of course that the amount itself is the product of a full and realistic assessment of operating subsidy needs. As you know, Mr. Chairman, this is a rather dramatic position to be taken by an organization that has fought long and hard for adequate inflation factors and full funding of annual operating subsidies. It is an indication of how very critical funding stability and predictability are to those who have to manage housing on a day-to-day basis. Equally important, this position is the result of certain assumptions concerning the national economy and the Reagan Administration policies. A radical depature from these assumptions, for example, significant curtailment in social security benefits, would create serious problems and call for reconsideration of funding levels.

Because of the short funding received up to and including FY82 and the fact that our proposal calls for a cap on the operating subsidy level for each of the 3 years, it is essential that the annual level of funding be equal to the real need for the first year of this program.

It is currently estimated that the need for operating subsidies for FY83 is $1.6 billion. There has been considerable discussion among the NAHRO membership and others as to the advisability of a cap. It is our feeling that with the other elements of this program and full funding, it is possible to cap the operating subsidy at this level. If, however, the funding level is less than the amount needed for that first year, it would be essential to index the subsidy to compensate for increased costs in subsequent years. The relief valve for some agencies unable to meet increased expenses with a fixed level of funding for the three years is the provision of our proposal which applies to authorities unable to convert to the new system during the period of the transition without facing inequities and fiscal hardship as a result of the transition.

- The second essential element of the proposal is to distribute the funds in accordance with an allocation system which is equitable to the largest number of participants (PHAs and tenants) in the public housing program. The NAHRO proposal retains the current statutory provision giving the Secretary discretion in determining the distribution system. NAHRO does not have access to sufficient data to determine the most equitable system. HUD is currently considering various alternatives, including modifications of the Performance Funding System, and the results of this study should help determine which system is finally selected.
- The third essential ingredient of the NAHRO proposal is the return to local PHAs of management control of their own operations. There is a need to reduce rules and regulations which detract from the management ability of housing authorities and which provide disincentives for sound management and for increasing revenues.

The federal statute and federal regulations need to be amended to authorize PHAs to set local income and rent schedules based on local conditions and needs, subject only to two national requirements: (1) that public housing serve lower income families within the eligibility range (i.e., up to 80 percent of median income in the local area) including families at the lower end of the eligibility range; and (2) that rents be set taking into account local housing market conditions and the rent paying abilities of families of various sizes and income levels within the eligibility range.

In operating under such a system as we have proposed, the one constant is the federal operating subsidy. To compensate for inflation and the normal escalation of costs, PHAs must critically examine all sources of income as well as areas for expense reduction. Further action might be possible to improve cost efficiency, reduce non-essential expenditures, improve coordination with state welfare department funding, and develop alternative rent schedules, for example, minimum rent, rent based on some portion of utility expense, or flat rents based on all or some portion of operating expenses.

The NAHRO proposal recognizes that conversion to any new system of funding will result in a need for supplemental assistance to some authorities during a period of transition to the new system. This has been evident in consideration of all of the proposals put forward during the past year. Any new system must be looked at in terms of the inequities the transition to the new system produces and steps must be taken to overcome those inequities.

We have reached the state in public housing where, for purposes of both the people being served and protecting the public asset, it is crucial that we have continuity and stability in the program. Federal assistance for capital expenditures and operations is essential if we are to continue to provide shelter for low income persons. This is a goal of NAHRO, its members and all of those administering public housing programs throughout the country. The NAHRO proposal assists these persons in achieving this objective. With your support and positive action, we can all go about the business of housing the poor through improved public housing operations. The alternative is to risk the collapse of our public housing edifice under the weight of burdens it was not designed to carry. The system we have now is clearly not working. Our public housing stock continues to deteriorate and services to the tenants are vanishing. We believe that local housing authorities in partnership with the federal government can develop a better system to serve the needs of tenants as well as exercise the stewardship that Congress and the public wants. Thank you, Mr. Chairman.

Michael A. Stegman

Housing vouchers: recommendations of the President's Commission on Housing

During the final 18 months of the Carter Administration, a five-year research phase of HUD's experimental housing allowance program was completed. Policy debates and discussions at that time sometimes raised such existential questions as whether any HUD effort that reduced relative housing expense burdens so much while contributing nothing to new supply and so little to improved housing quality had the right to be called a housing program.

There also occurred attempts, none of which materialized, to develop joint HUD/HHS initiatives to improve the housing situations of families receiving public assistance — particularly those receiving Aid to Families with Dependent Children who, despite their shelter allowances, continue to occupy inadequate housing at exceptionally high rates. A number of supply-side demonstrations, some of a self-help character in deteriorated inner-city neighborhoods and others in equally distressed but quite different markets in poor, sparsely settled rural communities across the country were under way. These efforts were either of a neighborhood rebuilding or stabilization character or were intended to encourage the private market to respond to rural needs by increasing the accessibility of existing mortgage insurance and other public programs to market actors in rural communities.

These occurrences are meaningful in light of five issues that relate to the recently released *Interim Report of the President's Commission on Housing* and its call for a program of consumer-oriented housing assistance grants. The issues are:

1—the importance of housing standards and the consequences of a transfer of a successful voucher program from HUD to the Department of Health and Human Services;

2—what EHAP does not tell us about the costs and optimal role of vouchers in a national low-income housing policy;

3—the adequacy of "supply" in urban and rural areas;

4—income eligibility and aiding the most needy poor; and

5—vouchers as a replacement for public housing subsidies.

Housing Quality Standards

The Commission expressed the view that, whatever size a voucher program might take, ". . . because the objective of national housing policy is a decent home for every American family, recipients of housing assistance grants should be required to occupy standard housing." A major concern, however, is the intent of of the Administration to get HUD out of the housing

Dr. Stegman is Professor of City and Regional Planning, University of North Carolina at Chapel Hill, and former Deputy Assistant Secretary of Research, Department of Housing and Urban Development, Washington, D.C.

business and the implications of such an eventuality in terms of the maintenance of housing quality standards in a voucher program. In a recent speech to the National Association of Realtors in Miami Beach, HUD Secretary Samuel Pierce underscored the Reagan Administration's commitment to get ". . . out of the business of building housing for low- and moderate-income families, and to use tax incentives to stimulate private investment in urban areas." Whether one favors this policy thrust is not the point. What is important is that, with the loss of its direct low-income housing production responsibilities, HUD will, *de facto*, if not *de jure*, relinquish its leadership role in the low-income housing area. The voucher function will be transferred to the Department of Health and Human Services and integrated into a public assistance block grant. The housing quality standards associated with housing vouchers surely will vanish.

> *"How in the world can housing authorities improve their competitive positions relative to private housing suppliers when the local authorities' financial condition is now being seriously undermined... ?"*

During the latter part of the Carter Administration, several state welfare directors proposed demonstrations that would link public assistance to HUD's Section 8 housing quality standards, incentives, and procedures for encouraging landlords housing welfare families to maintain their units at minimum levels of adequacy. These officials had been frustrated in their efforts to develop enforceable housing quality requirements wholly within their programs. Law, tradition, and the substantial ideological opposition that exists within the welfare establishment to earmarking and restricting the rights of public assistance clients to manage their cash assistance payments as they see fit—which could be necessary in some welfare-housing initiatives—hindered those efforts. Also, welfare shelter allowances frequently are inadequate to pay for decent housing. The linking of Section 8 to public assistance was viewed as a way of expanding welfare resources through a housing set-aside. In New York City, for example, the Section 8 fair market rent for an existing two-bedroom unit is at least half-again as high as the shelter allocation for a family of four in the public assistance program.

From a budgetary standpoint, a voucher program with a minimum housing requirement would probably be no more resistant to budget cutbacks than would one without such a requirement. The presence of minimum housing standards in a voucher program, however, probably could alter the way in which budget cuts are absorbed within the program. Holding constant the percent of income a tenant must contribute to the payment of rent, the size of a housing allowance payment is a function of the cost of housing that just meets the quality standard for the local market. Once the required tenant rent contribution is raised to its highest practical level, budget cuts probably would be absorbed by reducing the number of households receiving assistance; any reduction in voucher payments per participant would put the cost of standard housing beyond the program clients' reach.

Without a housing quality standard to peg the minimum size of the needed housing allowance payment, it is more likely that the response to significant program cutbacks would be the reduction of the average household subsidy, rather than a reduced number of program participants. If this occurs, even the modest housing impacts of a voucher program would disappear altogether.

Program Costs—A Misleading Issue

Many students of housing hold in high regard the quality of HUD's experimental housing allowance research and the policy significance of its findings. Because of EHAP, a great deal is known about housing consumption and mobility patterns of households that are potential beneficiaries of a voucher program. EHAP has generated solid data on likely participation rates among household groups in an entitlement program. The supply experiments also have produced empirical estimates of rent inflation rates in local markets (which are negligible) and the effects of allowances on housing conditions and the size of the supply, both of which also are quite limited.

Indeed, in the past, based on these and related EHAP findings, HUD's office of policy development and research unsuccessfully proposed modifications to the Section 8 existing housing program similar to some of those now being endorsed by the President's Commission and OMB. Among these proposed modifications were making Section 8 payments directly to tenants, rather than to landlords, and removing the FMR limit as a condition of occupancy while maintaining it as a basis for determining the actual subsidy a family receives. This latter modification means that a family wishing to occupy a dwelling that rents higher than the FMR would have to pay the full amount of the difference out of its own funds while any savings due to occupancy of a unit that rents below FMR would likewise be kept by the family. These changes would open up the housing stock available to participants and would have a dampening effect on program-induced rent inflation.

In discussing vouchers, it is important to distinguish between these and related policy implications that are directly related to EHAP and those that are misleadingly cloaked in EHAP. For example, while EHAP has produced very good estimates of the unit cost of assistance in an allowance program, the experiments reveal precious little about an optimal housing program mix or the extent to which national housing policy ought to be dominated by demand side programs. The President's Commission correctly indicates that "A basic equity problem of all subsidized housing is that relatively few obtain program benefits from among the eligible population." The fact that housing allowances cost about half as much as supply-side subsidies means that "Twice as many households can be served at any given level of funding under the consumer-oriented programs as under the construction programs." Despite implications to the contrary, the Commission knows that the Administration has no intention of using the cost advantage of housing vouchers to expand dramatically the fractions of the eligible population that would receive housing assistance under a voucher-type program and thereby lessen the equity problem inherent in supply-side programs. A much more likely scenario is one in which housing vouchers would replace housing development under existing supply programs, with the savings in contract and budget authority being extracted from the housing sector through recissions or reductions in future appropriations.

With respect to the issue of the higher unit cost of supply side programs, the Commission and the Administration point out that the so-called budget overhang of subsidized housing programs is so enormous that production efforts must be sharply curtailed. Outstanding obligations associated with the Section 8 new construction program alone amount to $110 billion and already extend a generation into the future. The total unpaid bill for all low-income housing constructed since the federal government got into the assisted housing business 40 years ago now totals $250 billion.

Budget data are no more informative nor instructive of a particular housing policy course than are similar kinds of data concerning the size of the tax expenditure budget for owner-occupied housing. The cost in terms of foregone federal taxes of just the mortgage interest deduction for home owners for the five years between 1982 and 1986 will be nearly twice the size of the entire 40-year, Section 8 budget overhang. That a cap on mortgage interest deductions and the conversion of the deduction to a tax credit could possibly save the government enough money to maintain an adequate level of low-income housing production, follows no more directly from the data on the size of the mortgage interest subsidy to non-lower-income home owners than does a policy of housing vouchers follow directly from data on the cumulative obligations associated with deep subsidy production programs.

The fact is that all the cost advantages of housing allowances really reveal is that whenever and wherever possible housing vouchers should first be considered as the principal housing assistance tool before resorting to supply-side efforts. Few would argue with this proposition. The important question is the extent and conditions under which, despite their higher unit costs, supply side programs may be necessary or desirable to achieve important local and national housing policy objectives; and whether local housing supplies are adequate to accommodate the housing needs of lower-income families.

Housing Adequacy

An important part of the policy debate on housing vouchers hinges on the adequacy—not of the nation's housing supply—but of thousands of local housing supplies to serve the needs of lower-income families, including those now living in physically adequate housing and those now occupying substandard dwellings. To the extent that the former have an excess rent burden, they could receive housing allowances in place. The latter would have to have their present units upgraded or would have to move to acceptable housing in order to receive rental assistance. The experimental housing allowance program indicates that upgrading is likely to occur as a result of housing allowances only if the needed repairs are very modest. Program incentives are just too small to encourage any real degree of rehabilitation and capital investment.

Here, the lessons of EHAP are instructive, but not decisive, in terms of national housing policy. The experiments demonstrated that while allowances have virtually no effects on the size of supply—in the experimental sites, at least—much of the existing stock responded well to program demands, and proved capable of being upgraded to minimum program standards at a per dwelling investment of no more than a year's cost of cigarettes for a light smoker. This, however, does not mean that the supply of available housing in all kinds of communities across the country is equal to the housing voucher task.

The designers of the allowance experiments acknowledge that their statistical findings should not be generalized. They do, however, argue correctly that the stability of important housing market outcomes across diverse pairs of supply and demand sites suggests that the findings are likely to be applicable to a cross section of communities far larger than the four experimental sites of Pittsburgh, Phoenix, South Bend, and Green Bay. Nevertheless, they stop short of suggesting that the national housing scene is no different than the EHAP picture "writ large."

Though somewhat reluctantly, the President's Commission acknowledges this fact. After emphasizing that the most serious national housing problem today is one of affordability and not housing adequacy, the Commission recognizes the existence of ". . . some geographic concentrations of inadequate units."

"They are found," says the Commission, "disproportionately in rural areas in the South and in older large cities. New York City and the nearby New Jersey cities of Newark, Paterson and Jersey City showed a particularly high concentration (19 percent), double the average of other large cities. Inadequate housing," noted the Commission, "also is more frequently found among certain types of households. Minority households—particularly black households—occupy such housing much more often than non-minority households. Female-headed households and the elderly also have above-average incidence of housing inadequacy."

When these bland acknowledgements are translated into housing conditions at the local level, their impact becomes more real. In New York City, for example, the results of a special housing and vacancy survey by the Bureau of the Census of the city's rental housing market shows very high levels of housing inadequacy among the above noted population groups. Using data on maintenance and equipment deficiencies similar to those used by the Congressional Budget Office and the President's Commission to identify housing in need of rehabilitation, this 1981 census survey indicates that:

—35 percent of all black and 38 percent of all Puerto Rican renter households occupy housing in need of rehabilitation;

—34 percent of all renter households containing five or more persons are inadequately housed, as are one-quarter of all female-headed renter households; and

—47 percent of all renter families receiving public assistance live in housing needing rehabilitation.

Indeed, spending a high proportion of one's income on rent does not guarantee occupancy of adequate housing in New York City. Nearly one-third of all households spending at least 40 percent of their incomes for rent also occupy inadequate housing.

Rather than concluding from its assessment of the inadequate supply problem that supply-side programs should be made more cost-effective and targeted to the areas most in need, the Commission proposes, essentially, that the government end these programs and open up the community development block grants to include low-income new construction. With large cities already struggling to cope with previous cutbacks in community development block grants, threatened with the loss of UDAG, and now fighting to fend off OMB's proposal to zero out block grants after fiscal year 1984, the Commission's proposal can be scarcely viewed as a responsible policy position. This is, of course, true not only in the case of large older cities. It is equally true for many rural communities, many of which have staggering concentrations of inadequate housing. In the state of North Carolina, for example, at least 20 percent of the rental stock in one fifth of the state's counties lacks complete plumbing for the exclusive use of its occupants. Many of these and other rural communities throughout the country have no certainty of receiving small cities CDBG funds, and little or no competence to develop and finance low-income housing without substantial technical support. Further, states preparing to assume administration of the program will now be less willing to provide that assistance in light of OMB's plans to phase out the program a few years from now.

What might inadequate supply mean to a housing voucher program? Having seen the housing statistics for New York City, a group of researchers from Pratt Institute in New York analyzed the city's Section 8 existing housing program to determine whether the high incidence of housing problems has made it difficult for various household groups to participate in this voucher-like program.

In their draft report now under review, the Pratt researchers found that 27 percent of the households that were issued Section 8 certificates between January 1979 and May 1981 never became recipients of any rental housing assistance. Households that either wanted to or who were required to move to receive Section 8 assistance were substantially more likely to become program dropouts than were households that wanted or were able to receive the subsidy in place. More than one half of the certificate holders who wanted to or had to move never received any assistance compared to only 15 percent of the certificate holders who were eligible to remain in place.

The families with certificates that wanted to or had to move in order to receive Section 8 comprised 56 percent of all non-elderly singles, 71 percent of all families with children, 63 percent of all non-elderly couples, but only 40 percent of all elderly singles and couples. Because of the difficulty of finding suitable housing in a tight New York City rental market that had a 1981 net vacancy rate of just 2.1 percent, 50 percent of all two parent families with children became Section 8 program dropouts. Fifty-one percent of all non-elderly couples never became recipients. Only 15 percent of all elderly couples and 30 percent of all elderly singles with certificates failed to receive Section 8 payments.

Defining the Eligible Population

As a basis for allocating scarce housing resources, the Commission properly argues that assistance should be targeted to those most in need. One might concur with the operational definition of the urgent needs population, namely, households whose incomes are very low, no higher than 50 percent of the area median. Nationally, the Commission points out, the incidence of housing inadequacy among very low-income renters is twice as great as among low-income renters—20 percent, compared to slightly more than 10 percent.

This is not necessarily the case among Section 8 existing housing program participants in New York

City, where important differences exist between very low-income and low-income households. Should these differences be repeated elsewhere in the country, the very low-income program eligibility criterion could have unintended and undesirable screening effects.

According to the Pratt Institute researchers, very low-income Section 8 recipients tended to have the following characteristics:

—a majority are white (58 percent),

—a majority are elderly (60 percent),

—a small minority (22 percent) had children in the household, and

—only slightly more than one-third wanted to or were required to move to receive Section 8 benefits.

In stark contrast, the researchers found low-income program participants, those with incomes between 50 and 80 percent of the area median, to be:

—disproportionately minority (66 percent were black and 15 percent hispanic);

—more likely to be households with children (52 percent are one parent households with children and 25 percent are households with two parents and children), and

—likely to have to move in order to qualify for Section 8 assistance (73 percent of low-income Section 8 recipients fell into this category).

In short, it is not that clear that the degree and urgency of housing need among poor people is simply a function of just how poor they are.

Despite agreement with the Commission's view that a larger part of the low-income housing program burden can be properly, responsibly, and effectively shouldered by a demand-side program, one concludes a reading of its Interim Report feeling very ill at ease. A significant amount of discomfort comes not from the Commission's work itself but from concern over how its analysis and recommendations will be interpreted and used by an Administration that is generally unsympathetic to the housing needs of poor people.

A good example can be illustrated in the potential relationship between housing vouchers and public housing subsidies. Under certain conditions, among them being the elimination of serious problems of deferred maintenance and the improvement of the energy efficiency of the public housing inventory, one could support the Commission's goal of having consumer oriented housing assistance grants eventually replace public housing operating subsidies. The theory is that if local housing authorities cannot successfully compete in the open low-income market place for voucher-enhanced low-income consumers' housing dollars, then perhaps they should get out of the business. The practical dangers of embracing this goal, however, are two-fold. First, the Commission proposes that the budget authority associated with vouchers should be limited to between three and five years. This means that local public housing authorities would soon find themselves with tenants who will be unable to pay their rents three years down the road, a condition in the private rental housing market that leads investors to adopt very short run investment strategies of undermaintenance and eventual abandonment. Second, and more important, while it is a good intellectual exercise to theorize about the outcomes of the competitive interactions of unfettered public and private housing suppliers as they vie for the low-income housing dollar, in the present budgetary environment, this theorizing is no more than that—an intellectual exercise.

How in the world can housing authorities improve their competitive positions relative to private housing suppliers when the local authorities' financial condition is now being seriously undermined by the Administration's callous disregard for their demonstrated needs for continued operating subsidies? Each day brings either another release or news leak that reads like a weather report during a cold snap. A short time ago, the weather was mild, the breezes balmy and housing authorities were going to be funded at a level of 82 percent of demonstrated need. Then, the clouds rolled in and the "temperature" dipped to 75 percent and, according to some, the true operating subsidy reading was just 69 percent in the shade. In the first week of December, the storm clouds gathered, the sky darkened, and OMB's forecast was for a fiscal year 1983 operating subsidy level of a frigid 25 percent of true need.

The irony of all this, of course, is that the Administration seems intent on destroying the public housing system that the President's Commission wants to see become more market-oriented and competitive in the future. If OMB's plan is adopted, the outcome of the market test will be very predictable and the Administration's anticipation of the failures of the public housing system will become a self-fulfilling prophecy.

In their increasingly debilitated states, housing authorities will be unable to compete successfully for the voucher-enhanced consumers' housing dollar. The most upwardly mobile families will leave public housing first, followed by others who are able to navigate in the local market. Enough tenants would leave their assisted units to assure the financial failure of many projects and local authorities. Not all projects would empty out, however, because local housing supplies will be unable to respond to the increased demand. As local projects deteriorate still further, they will become centers of frustration, tension, and unrest. More families will flee public housing, doubling up will increase in some cities, and private market rents would rise. Because the voucher program puts no cap on allowable rents and only a small portion of eligibles would be receiving rental housing assistance, more and more poor people would have to pay very high fractions of their incomes for inadequate housing. And toward what end? Merely to test the Commission's theory of housing market competition among private and public housing suppliers. The cards in the deck were stacked by OMB from the beginning.

BY AUTHORITY

RESOLUTION NO. 17

SERIES OF 1982

INTRODUCED BY

Reynolds and Swalm

A RESOLUTION

SUPPORTING THE HOUSING POLICY OF THE NATIONAL ASSOCIATION OF HOUSING AND REDEVELOPMENT OFFICIALS (NAHRO) ALLOWING PUBLIC HOUSING AUTHORITIES TO ESTABLISH A FLEXIBLE RENT STRUCTURE.

WHEREAS, the Housing Authority of the City and County of Denver is required to establish a tenant-rent structure pursuant to State and Federal laws; and

WHEREAS, from 1937 to 1971, the Housing Authority complied with State law which has allowed the establishment of flat rents for tenants receiving public assistance; the rent for public assistance equaled monthly operating costs and therefore the Authority required no federally assisted operating subsidy; and

WHEREAS, in 1970 and 1971 Congress passed the Brooke Amendments to the Federal Housing Statutes which established a maximum rent-to-income ratio not to exceed 25% of each tenant's adjusted income; the implementation of the Brooke Amendments necessitated an annual operating subsidy from the Department of Housing and Urban Development and prohibited the Housing Authority from increasing its rental income; and

WHEREAS, since 1980 the Congressional appropriations of operating subsidy have not been sufficient to fully subsidize the Housing Authority;

BE IT RESOLVED BY THE COUNCIL OF THE CITY AND COUNTY OF DENVER:

Section 1. That the City Council of the City and County of Denver advocate the repeal of the Brooke Amendments.

Section 2. That the City Council support the housing policy of the National Association of Housing and Redevelopment Officials (NAHRO) which will allow local public housing authorities to establish a flexible rent structure which will decrease the dependency of housing authorities on federal operating subsidies and allow the establishment of flat rents and return local decision making to the local Authority's Board of Commissioners.

Section 3. That the Clerk of the City and County of Denver forward a copy of this Resolution to the Colorado Congressional delegation and appropriate Congressional committees, and attest and affix the Seal of the City and County of Denver to this resolution.

PASSED BY THE COUNCIL March 15, 1982

William R Roberts - President

APPROVE: WH McNichols, Jr. - Mayor March 17, 1982

ATTEST F. J. Serafini - Clerk and Recorder,
Ex-Officio Clerk of the
City and County of Denver

BUDGET PROPOSALS

Mr. Adams. NAHRO is very concerned about the fiscal year 1983 budget proposals. We are concerned that they represent a step toward Federal withdrawal from housing and community development, and our written testimony gives the reasons why we feel this way. We feel that the community development and UDAG program should be funded at the authorized levels. We feel that section 312 and section 108 should also continue to exist. They have worked well and we would hope that they would continue.

There is a real need for housing production in many communities around the country. We would support a production level in fiscal year 1983 of 24,000 units, and NAHRO opposes the rescission of the fiscal year 1982 appropriation. Most of our members feel that if it is not broke, you should not fix it. We feel the section 8 existing program, and the section 8 moderate rehabilitation program have worked very well. We would like to see them continued. There are some elements of the section 8 modified certificate program that are improvements, but total new programs take a while to become effective, and the section 8 program is working very well.

We are also concerned that the fiscal year 1983 recommendation of funding really does not provide any additional families' entrance into the program except in the rehabilitation component. I know in Dade County we have a waiting list of 12,000 for section 8 existing. If no new families are added, somebody coming in today will have to wait 100 years to get to the top of the list. In public housing they would have to wait 20 years. We feel this is too long.

We approve the funding level of the comprehensive assistance program, but since we oppose the rescissions, we would suggest that the funds for this would have to come from new funds. The two elements that I will spend most of my time in my oral statement on, is on new policy for public housing operations and some of the concerns we have with the directions coming out of the administration. We think the No. 1 priority in housing has to be to make existing public housing fiscally and physically sound. Our members are very concerned with what we view—maybe with a sense of paranoia, but what we view as impediments to good management coming from administration policies and proposals.

We are concerned that the fiscal year 1982 operating subsidy appropriations only gives us 96½ percent of what we need. In order to get those funds, we have to waive any rights to further funds. The funds still have not been distributed, and we are losing the possibility of earning interest on the additional operating subsidy. We think the administration's assumptions that make $1,152 million equal to 100 percent of needs in fiscal year 1982 are fallacious. We do not think that 10-percent savings in consumption of utilities that can be achieved. We do not think that tenant rents will increase an average of 11 percent. The rental income, for one thing, assumes the implemenation of the 26- and 30-percent ratio to income. That has not been issued yet, and certainly authorities whose budget began January 1 will not get the full benefit of that.

We also feel that with unemployment levels at the rate they are, and with the cutbacks in Federal income support, we may be losing income from some of our families rather than gaining. The administration estimates that when the lease and grievance procedure is revised and deregulated—and again there are authorities who started the budget year without this deregulation—we do not believe that will result in a 5-percent saving in administrative costs. That would not be our experience in Dade County.

Finally the assumption that State and local governments will add $41.6 million to operating public housing, we seriously question, because most States and most localities are facing budget problems at least as serious as the Federal Government. Many are going to have to pick up funding programs where Federal participation is less, and we seriously question that source of funds. If we think that $1,152 million is not enough for fiscal year 1982, obviously, we think $1,075 million will not be enough for fiscal year 1983. We are concerned with the impact of these assumptions. I think what the administration has done is, it has taken the level of funding that they were given, and if that is all that is available, these are the changes that will have to be made. We think the changes will hurt public housing and send us into further management problems. Since our testimony was written, our concern about the loss of HUD participation in some of our conferences and workshops has been resolved. Under Secretary Hovde has called NAHRO and says that that policy has been modified, so that part of our testimony would no longer be valid.

We think that public housing is really very well-managed. We would agree with Assistant Secretary Abrams that the vast majority of authorities do a good job. You can go around the country and see projects that are 40 years old that are attractive and physically in good shape. We would place our record of management against any other management technique for low-income familes, but we have trouble. We have an unpredictable level of funding. We are limited in the rents we can charge. We often are well into our budget year before we know the level of funding, and for this reason, NAHRO has proposed a three-part approach to operating public housing. We would recommend a 3-year commitment of operating subsidy funds at a fixed level of what we believe the needs are in fiscal year 1983, $1.6 billion.

The distribution of the funds ought to be by a fair formula, and we will withhold judgment on how that should be done until HUD completes its studies and all of us have a chance to review it. I know it is a very difficult study that HUD is doing, but we would want to review what the recommendations are.

SOURCES OF INCOME

Finally, we think if our two main sources of income are from operating subsidies and tenant rents, that we should have flexibility to set tenant rents, so that we have a balanced budget. The only limitation that we would have is that public housing must house a cross section of the lowest of the low-income families, and any rent structure that we set would have to achieve that objective. We are not talking about increasing the limits for occupancy of public housing. The law, as it presently exists, is the law that we would want to operate under. There may be a few housing authorities who have special problems. It may take several years before they can phase into this new system, and we would think that they would have to have special treatment.

This proposal was adopted last year by NAHRO. Implicit in the policy are certain conditions of the national economy. Obviously, if high unemployment continues that would adversely affect our recommendation. If we return to double digit inflation, which we hope we won't, that would affect our policy. If we return to runaway energy costs which is not presently the case, but if we do, that could affect our policy. If there are substantial sizable curtailments of Federal income support payments, that could affect our policy. And if some of what we view as impediments to good management coming from the administration continue, that could affect our policy. But if none of these potentially costly future adverse conditions come into being, we would certainly support every element of our policy.

Thank you.

Senator **LUGAR**. Thank you very much, Mr. Adams.

Mr. Adams leads one of the large agencies in this country, and Mr. McLean, my Hoosier constituent today, represents a fine city on the Ohio River, a smaller agency, and we wanted to get some idea of how the housing authority, the size of New Albany, Ind., might testify today. We are delighted you are here.

HOWARD McLEAN, EXECUTIVE DIRECTOR, HOUSING AUTHORITY OF NEW ALBANY, IND.

Mr. **McLEAN**. Thank you, Senator. We have three things here outlined that I would like to bring to your attention to keep housing authorities operating at efficient rates. One, we feel that a minimum rent would be very advantageous to all housing authorities. I will get into the numbers a little bit later on here. We have people paying as low as $3 a month rent, where we are picking up all the utilities, with the exception of electric, and we give them an electrical allowance. We used to have a minimum rent, which worked out very well.

HOUSING AND UTILITY ALLOWANCES

In the State of Indiana the welfare recipients get housing allowance. We can take 25 percent of that. If they are allocated $75 we still only get 25 percent of it, so that gives us an $8 to $10 to $12 a month rental for the unit. We feel if we could get a minimum rent for zero bedroom, which we have some for the elderly, it would run $40 per month. One bedroom, a minimum rent of $50, a two bedroom, $60, three bedroom, $70, and a four bedroom is $80 a month, that we could operate with a 25-percent reduction in Federal subsidies and still keep everything in the safe, sanitary condition that we are in right now.

Second, we have a utility allowance for electric—we pay gas, water, sewage, and garbage collection. The tenants pay electric, but we give them an allowance. On a one-bedroom unit, there is $11 monthly electrical allowance, two bedroom, there is a $14 allowance, on the three bedroom, it is $16, four bedroom, there is a $17 monthly allowance for electricity used. All of the other utilities are paid.

With a minimum rent and deletion of the electrical expenses here, the New Albany Housing Authority could make a savings of $161,400. This year—last year our Federal subsidy was $550,450. With a 25-percent reduction in the subsidy of the current year, our net from the Government would be $410,476, a decrease of $139,974, but with these—with a minimum rent and deleting of the electrical allowance, we would pick up a total $161,400—which would be an increase over what we have now. And we could maintain the New Albany Housing Authority with the 25-percent reduction in Federal subsidy by a minor change.

Now in everybody's mind, the first thing you say when you're going to raise something, you automatically pick on the elderly. That is not the case in New Albany. The elderly rents are much higher. They pay for the family units, so it would affect, in New Albany, where we went to $50 for one bedroom—we would affect 4 elderly families out of 325. One of them would be affected $2, two of them would be affected $3 per month, and one would be $9 a month. That is what we would expect as far as the elderly goes with the New Albany Housing Authority. I feel that if we could get this legislation, or for you to even give it a look or bring this around, that we could operate with the 25-percent reduction satisfactorily.

[Copy of material received from Mr. McLean follows:]

THE HOUSING AUTHORITY OF THE CITY OF NEW ALBANY, INDIANA

HOWARD MC LEAN, EXECUTIVE DIRECTOR

1. Minimum Rents - The New Albany Housing Authority feels an established minimum rent per unit according to size (based on the local of the Housing Authority) would help to alleviate some of the financial problems many of the Housing Authorities are facing today. Currently, our Authority is expending more funds per month on utilities alone, without regard to any other operating expense, than the average rental received on that unit.

2. Rental Adjustments - We feel no rental adjustment for new tenants until after expiration of one calendar year with the single exception that such an adjustment would be made for a tenant who has been laid off from his or her job.

   The problem our Authority has had is that very frequently a working tenant is admitted and pays a reasonable rent, but shortly after admission will quit his or her job, go on welfare, and his rent is accordingly adjusted considerably downward. Not only does this hurt the Housing Authorities income situation but makes it next to impossible for the Authority to maintain its proper Broad Range of Income ratio.

3. Utility Allowance - In view of the recent Performance Funding System cutbacks, the allowance for utilities for tenants should be eliminated. The elimination of the utility allowance along with the establishment of a minimum rent would greatly aid the public housing financial situation.

The Housing Authority Of The City Of New Albany, Ind.

Howard McLean
Executive Director
Secretary Treasurer

Eugene F. Lind
Counsel

Central Office
169-71 Woodland Dr.
P. O. Box 11
New Albany, Indiana 47150

Commissioners
Mark L. Elrod
Chairman
Kenneth M. Sinkhorn,
Vice Chairman
Larry J. Alt
Mrs. Evelyn Nicholson
Jim W. Harrell

GENERAL INFORMATION

Established in 1937

862 Dwelling Units ranging from 0 Bedrooms to 4 Bedrooms

120 Family Units and 100 Elderly Units currently under construction

1 - Maternal Health Clinic

1 - Prenatal Health Clinic

HUD Jurisdiction - Indianapolis Area Office

- Chicago, Illinois Regional Office (Region V)

MINIMUM RENTS - Based on our current tenants, our rental income could be increased by $4,401.00 per month or $52,812.00 per year if we were allowed to establish a Minimum Rent on our dwelling units. The Minimum Rents we used to establish these figures are as follows:

0 Bedroom	$40.00 per month
1 Bedroom	50.00
2 Bedroom	60.00
3 Bedroom	70.00
4 Bedroom	80.00

The Housing Authority currently pays the gas, sewage and water service for each unit as well as an electrical allowance depending on the size of the unit. The hardship this is creating for our Authority is the fact that we have tenants paying as low as $10.00 per month. By establishing a Minimum Rent we would be able to get some return on the utilities which could offset our loss each year.

UTILITY ALLOWANCE - The Housing Authority currently gives each household depending on the size of the unit an electrical allowance with the exception of the elderly high rises. They are as follows:

1 Bedroom	$11.00
2 Bedroom	14.00
3 Bedroom	16.00
4 Bedroom	17.00

Based on our current tenants, our rental income could be increased by $9,049.00 per month or $108,588.00 per year if we were allowed to eliminate the electrical allowance. The Housing Authority pays all other utilities in full.

HUD ASSISTANCE FOR OUR FISCAL YEAR 1981 - 1982	$550,450.00
HUD ASSISTANCE FOR OUR FISCAL YEAR 1982 - 1983	$410,476.00
TOTAL DECREASE	$139,974.00

INCREASE BY ESTABLISHING MINIMUM RENTS	$ 52,812.00
INCREASE BY ELIMINATING UTILITY ALLOWANCE	$108,588.00
TOTAL	$161,400.00

With legislation, our Authority could recoup the funds lost from the recent budget cuts and realize an additional $21,426.00 per year.

Senator LUGAR. Thank you very much, Mr. McLean.

I would like to call upon my colleagues now for questions they may have of the witnesses.

Senator Dixon, did you have an opening statement prior to getting into questions today?

Senator DIXON. No, I have no opening statement, Mr. Chairman. I have some questions.

Senator LUGAR. All right. I will call upon Senator Dodd, first of all, for his statements.

Senator DODD. Thank you, Mr. Chairman. I appreciate the witnesses being here today. Particularly, I am delighted to see Mel Adams. We miss you in Connecticut.

Mr. ADAMS. I enjoyed it there, but not the winters. [Laughter.]

Senator DODD. You are anticipating one of my questions. We are delighted to have you here with us.

If I could, Mr. Abrams, you may recall that it was at least my understanding that the Department in requesting its fiscal 1983 budget for public housing operating subsidies, there was a request for a little over $1 billion. I wonder if you might tell me what percentage of the operating needs of the local public housing authorities will be met at that level?

OPERATING SUBSIDIES

Mr. ABRAMS. As with this year, with the revisions in the distributions formulas, the $1.075 billion will fund housing authorities at 100 percent of their performance funding system.

Senator DODD. How do you reconcile that with the formal appeal to OMB, which requested $1.5 billion?

Mr. ABRAMS. You are talking about documents, and I am not sure—the $1.5 billion figure does not ring a bell. When you are talking about——

Senator DODD. Is that a correct figure? Is that the figure you used in the formal appeal?

Mr. ABRAMS. I do not remember. There is certainly a number of documents circulated that were internal documents or staff documents that never got out——

Senator DODD. I am talking about the formal appeal from HUD to OMB.

Mr. ABRAMS. I do not have the papers with me. I'm not familiar what the appeal number was.

Senator DODD. Was the appeal larger than the $1.075?

Mr. ABRAMS. Yes. In negotiating situations normally people ask——

Senator DODD. How do you reconcile that with saying that you reached 100 percent of your operating subsidy?

Mr. ABRAMS. Because OMB pointed out to us that there were some fallacies in our——

Senator DODD. Who is in charge of housing? Does the OMB know about housing?

Mr. ABRAMS. We are in charge of housing. OMB is in charge of the budget and has been monitoring the excesses——

Senator DODD. My question is, is the $1.075 adequate. You tell me it is 100 percent, yet in the formal appeal you ask for more.

Mr. **Abrams**. I was about to explain that. If you would like me to, I will finish the explanation.

Senator **Dodd**. I would like you to.

Mr. **Abrams**. In the formal appeal, we asked for money based on a set of assumptions generated by our staff. The OMB staff, which has been monitoring the housing programs for several years, raised many policy questions which we had not considered. And when the Secretary became aware of the different options and some of the policy questions that were raised by OMB, he then agreed to a compromise figure of $1.075 billion.

Senator **Dodd**. What did OMB know that you didn't know?

Mr. **Abrams**. They knew there was a lot of energy consumption that had been going on in the housing authorities without any restraint. Many housing authorities had not practiced the type of restraints that were pointed out in the House Appropriations Committee conference report language in citing the fact that energy conservation has not been practiced in many housing authorities.

Although we did not agree or accept OMB's estimates of what the excesses in utility consumption were, our evaluation of the Department of Energy figures, as well as some various other data—which I believe I have copies with me—indicate that the private sector has reduced energy consumption, and yet we were still assuming authorities were operating at the same amount of consumption per unit as they were in the years 1973 through 1976. And I do not think that was any longer a valid assumption. So, it was appropriate for us to change the assumption.

Senator **Dodd**. Let me, for the record, Mr. Chairman, cite the December 2, 1981 appeal from HUD to OMB.

"The Department requests $1.373.8 billion budget authority for the operating subsidy for 1983, even at this level"—I am quoting from the appeal—"even at this level, as it is well below the estimated need of $1.5-plus billion. Based on the most recent data, however, the Department hopes to reduce costs of such measures with improved management."

That was the formal request that was made at the time.

In that appeal, that draft appeal that HUD made to OMB, there was some suggested consequences that would occur as result of the present levels of support for housing. And I may quote some of the suggesting consequences that were written by HUD. These are not words that were drafted by some outside group.

The appeal said that "funding levels would be"—I am quoting—"The consequences of these fundings levels would be rent strikes, violence, riots, vandalism, major political disruptions in several large cities."

I wonder if you might suggest whether or not you think that is a possibility as a result——

Mr. **Abrams**. I do not think it is a possibility. What you are reading from is a lower-level staff draft that was not approved at any policy level. It is based on traditional attitudes toward open-ended Federal purses that were available for whatever budget demands are placed upon it. They do not reflect any reasonable evaluation of how the system operates or what the consequences are going to be. They are completely unfounded.

Senator DODD. Mr. Adams, you're out there in the field. Do you think that appeal, that draft appeal that suggested those consequences is a correct assumption?

Mr. ADAMS. I think the assumptions about how costs are going to be reduced, so that $1.075 billion meets the needs, I think those are erroneous assumptions. And what will happen is either we will have to increase tenant rents dramatically, far over what we would propose in the NAHRO policy, or public housing will deterioriate. And you overlay this on cutbacks in Federal income support programs and high unemployment.

And a very unfortunate situation is developing. I would never predict riots or disorders. I think that could become a self-fulfilling prophecy. But I think real danger will exist in our public housing.

Senator DODD. I wonder if you might comment. In your testimony, Mr. Adams, you did not address some legislative initiatives. Senator Cranston and I and others have introduced legislation. It has also been introduced on the House side. The Senate bill, number S. 2171, the Rental Housing Production and Rehab Act, I do not know if NAHRO has had a chance to look at that or not.

Mr. ADAMS. Yes. I think there are many parts of our testimony—although we were not testifying on your bill— that are supportive of your bill.

We generally feel that the housing of low-income families is best done by public housing authorities and nonprofit sponsors under section 202. But there also needs to be a housing program for shallow subsidy for moderate- and middle-income families, and NAHRO would be supportive of your bill.

Senator DODD. I would appreciate it if you might—you may have already submitted testimony specifically on the bill in the House. I would appreciate any formal comments you may have on that.

Mr. ADAMS. If we could keep the record open, we will submit a written statement on your bill.

Senator DODD. If there's no objection.

Senator LUGAR. The record will be kept open so that the statement can be submitted.

[The following information was received for the record:]

NAHRO
Serving the Nation's Housing and Community Development Needs

May 3, 1982

Honorable Christopher J. Dodd
404 Russell Senate Office Bldg.
Washington, D. C. 20510

Dear Senator Dodd:

You asked at the April 15 hearing of the Subcommittee on Housing whether NAHRO would be able to make formal comments on your bill, S2171, the "Rental Housing Production and Rehabilitation Act of 1982". We are delighted to do so.

Senator, we wish to commend you for authoring a creative new approach to multifamily rental housing production and rehabilitation. NAHRO supports S2171 for the following basic reasons:

(1) It meets an urgent need for new and substantial rehabilitation of rental housing among many local communities with low vacancy rates and almost no multifamily housing construction. Although there are those who will produce a flurry of national statistics to prove that there is no rental housing crisis in this country, anyone who has tried to rent an affordable unit recently would have a different opinion. Public housing authorities are still able to house only 13% of the qualified population; their waiting lists are extensive. Statistics from HUD's Annual Housing Survey show that, as of 1978, over 7 million households were still housed in substandard or overcrowded conditions; over 3 million households were paying more than 60% of their incomes for rent. As household formations, abandonments, and conversions increase, the national rental vacancy rate has fallen well below 5% and in some individual markets it is as low as ½ of 1%. Production of rental housing in the private market has virtually ceased. Short supply and low vacancy rates are putting tremendous inflationary pressures upon the existing housing stock. As

moderate and middle-income persons are finding it harder and harder to find affordable units, low income persons are being forced out of the market entirely.

(2) It targets needed assistance to those areas most in need. The requirements of your bill direct assistance to areas with severe housing shortages, documented housing needs, and a lag in rental housing production. Further, NAHRO sees a particular need for new and substantially-rehabilitated rental housing to be used in conjunction with local community development programs. A joint survey recently completed by NAHRO and five other national organizations documented that in the 75 cities surveyed, there was an urgent need for an assisted housing allocation of 240,000 units just to accommodate the housing component of CDBG program for the next year. Without such housing, these community development programs cannot move forward to meet their objectives.

(3) It incorporates a sound requirement for supportive local private and public participation in financing and implementing the proposed development. The experience under the UDAG program confirms the practice of having firm supporting commitments from local private and public sources, so that the federal assistance can be used to supplement available resources.

(4) It incorporates a highly-desirable flexibility as to how the federal assistance can be used, in order to complement local available resources and use their assistance in the most effective way to develop a feasible housing development.

(5) It requires that a fixed proportion (20%) of the assisted units be available to lower income households, and includes an incentive to the sponsor to increase their proportion, where feasible.

NAHRO is pleased to indicate its strong support for S2171.

Sincerely,

Robert W. Maffin
Executive Director

As of November 1981, NAHRC estimated that with regard to 26 PHAs representing 30% of the total federally-subsidized public housing stock, over 311,280 eligible households were waiting for federally-funded public housing. The percentage increase in public housing waiting lists from 1980 to 1981 by selected PHA, was as follows:

PHA	% Increase
Columbus	25.7%
Dade	34.2
Detroit	15.8
Cuyahoga Co.	48.2
San Antonio	21.9
Denver	38.9
Minneapolis	27.2
Hano	.86
Memphis	38.4
Buffalo	48.7
Nashville	17.5
Baltimore	12.6
Atlanta	5.8
St. Paul	89.9
New York	7.1
Pittsburgh	23.6
Mean =	28.5%

Of the 22 PHAs responding, 16 or 72.7% of them had increases in their waiting list from 1980 to 1981. The average increase of these 16 PHAs from 1980-1981 was 28.5%.

1982 Shortfall in Public Housing Operating Subsidies: NAHRO's Assumptions and Calculations Vs. Those of HUD

Although the Administration has not requested a fiscal year 1982 supplemental appropriation for public housing operating subsidies, one is clearly desperately needed. There are obviously, many false assumptions used in the Department's estimates for fiscal year 1982 as contained in their letter of February 22, 1982, to the Senate Appropriations and HUD-Independent Agencies subcommittee and the attachments thereto. We would like to comment upon certain of HUD's calculations and conclusions with which we disagree. Our figures are based on a public housing survey recently conducted by NAHRO. In particular our comments are addressed to pages five through eight of the HUD document entitled, "Public Housing Operating Subsidy Requirements for FY1982" (attached).

Allowable Expense Level: Plus $32.8 Million

- o In general, we accept the retrospective inflation adjustment suggested by HUD on page 6 of their document. We do not accept the downward revision for non-utility inflation to 7.5%. There is no sound reason to reduce this estimate from the previous HUD figure of 8.6%. This increases the HUD estimate for allowable expense level by $12.8 million
- o We do not accept the $20 million reduction as a result of streamlining of lease and grievance procedures. If and when the revised procedures come out, the impact will not be near what HUD is suggesting, and in any case, it is in fact impossible at this point to measure. Thus, we would increase the AEL by $20.0 million

Utilities: Plus $176.9 Million

- o We accept HUD's data on the first three quarters of FY81. We accept their estimate of the FY81 utilities adjustment. Our survey indicates that the utility rate increase from 1981 to 1982 was 18.9%; therefore, we must add $33.3 million to this item. We reject the reduction in allowable utilities consumption level of $103.6 million. We reject the payback on modernization funding, $40 million. This results in an increase of $176.9 million. Neither of these two proposals are realistic or rational. They are merely an arbitrary means to reduce the level of operating subsidy.

Income: Minus $67.2 Million

- We accept the HUD FY81 experience figure. Our survey indicates increases in income for 1982 to be 4%; this results in a downward adjustment of $34.2 million in HUD's estimate. We reject the $25 million estimate of increased income as a result of increased rent-to-income ratios of 26% in FY1982. The regulations are not out yet; they call for implementation over year one, and a good part of the year is over. Therefore, no additional income should be counted for this year. We reject the projected additional $8 million income from new tenants being brought in at 30% of adjusted family income for the same reasons of timing and practicality. This results in a decrease of $33 million in HUD's estimate.

Insurance Costs

- We reject HUD's projected savings of $17 million. Separate funding for insurance outside of the PFS is something we have supported for many years. These costs are not adequately covered in the Performance Funding System.

Non-PFS PHAs

- We accept HUD's estimate of $8 million in operating subsidy requirements for these PHAs.

State and Local Contributions: Plus $41.6 Million

- We categorically reject any assumed increase in state and local contributions to public housing. This assumption ignores the very serious financial condition faced by state and local governments due to reduced revenues as a result of the recession, and their need to assume the costs of programs where the previous federal contribution has been substantially reduced.

Two months ago, NAHRO's preliminary analysis of the actual FY82 operating subsidy need was $1.528 billion. As a result of our public housing survey, we have firmly established that the real need for FY82 is $1.487 billion, resulting in an operating subsidy supplemental appropriation need of $335.5 million.

Estimate of 1983 Public Housing Operating Subsidy Need: NAHRO's Assumptions and Calculations versus HUD's.

The Administration's FY83 estimate includes:

- An inflation rate increase of 7.5 percent;
- A utility rate increase of only 9.3 percent, when economic forecasts predict the rate will be at least 11 percent: NAHRO supports an 11% projection.
- An increase in tenant income of 7 percent when (a) over 30 percent of public housing tenants are AFDC recipients whose income will not rise due to other federal program cuts; (b) unemployment is at a 40 year high and continually increasing; and (c) economic forecasts indicate that blue collar wages are expected to increase by only 7 percent. Therefore, we believe it is impossible for the net effect to be a 7 percent increase in income: NAHRO estimates the increase to be at a rate of 3.7%.
- An increase in gross tenant rental income of $50 million due to the 1981 legislative amendments to increase the rent to income ratio. However, HUD assumes a 20% rental increase cap which has not been supported by the Congress, therefore NAHRO suggests the increase in income will be only $25 million.
- A $100 million savings resulting from the inclusion of food stamps as income. This change has not been approved by Congress therefore NAHRO rejects this "savings."
- A $172 million savings resulting from HUD imposed reduction to the allowable utilities expense level supposedly reflective of potential energy savings. These reductions are arbitrary and not supported by any rational basis or plan for energy conversation. We strongly support energy conservation and are currently working with HUD and housing authorities to develop a system of determining reasonable utility consumption levels. Some changes might be implemented by 1983, but until they are defined, no estimates of savings can be made.

  Utility costs represent over 40% of a PHA's operating costs. Most PHAs have been successful in the last few years in reducing their consumption, particularly heating fuels. The significant increase in utility rates accounts for the gross increase in utility costs. At the request of the HUD Under-Secretary, NAHRO is working with HUD to develop a modification to the PFS which will provide incentives to encourage energy conservatism and insure that over-consumers of energy are not rewarded. We hope to agree on a proposal soon.
- A $23 million savings due to deregulation. While we also support maximum deregulation, we do not believe it will result in significant savings. Most of the deregulation is the result of the federal regulation duplicating a local or state requirement.

- Lastly, HUD anticipates $93.2 million to be contributed to PHAs by state and local governments. While state and local governments have and to some extent will continue to contribute to the public housing program, these contributions are in the form of capital improvements, supplemental and extra-budget support services. Almost uniformly, state and local governments have not contributed to the operating budgets of housing authorities. Reduced resources at the state and local level preclude any such contribution at this time and as a result should not be considered an offset to the federal obligation to operating subsidies.

NAHRO feels that $1.6 billion is the level of operating subsidy of FY83 which is responsible, maintains incentives for good management and energy conservation and which permits housing authorities to serve their low income tenants.

Comparision of FY 1982 and FY1983 Estimates of PFS Need

(Dollars in millions)

		HUD's Current 1982 Estimate	NAHRO 1982 Estimate	HUD's 1983 Estimate	NAHRO 1983 Estimate
	PFS Base	1356.3	1423.8	1530.7	1638.0
(+)	Insurance Costs	0.0	17.0	0.0	17.0
(+)	Non PFS	47.0	47.0	45.0	47.0
(-)	Rent to 26%	-25.0	0.0	-50.0	- 25.0
(-)	New tenant rent 30%	- 8.0	0.0	-27.0	- 16.0
(-)	Elimination of negative rents	0.0	0.0	- 7.0	0.0
(-)	Inclusion of food stamps	0.0	0.0	-100.0	0.0
(-)	Reduced utility consumption	-103.6	0.0	-121.7	0.0
(-)	Utility reduction due to modernization	-40.0	0.0	-50.0	0.0
(-)	Revised inflation factor (7.5%)	-12.8	0.0	-28.8	- 28.8
(-)	Deregulation	-20.0	0.0	-23.0	0.0
(-)	State and local contributions	-41.6	0.0	-93.2	0.0
Subtotal:		1152.3	1487.8	1075.0	1632.2
Difference between total Requirements and Administration Budget		0.0	335.5	0.0	557.2
Total:		1152.3	1152.3	1075.0	1075.0

Senator **Dodd**. I have more questions, but I will stop at this point.

Senator **Lugar**. Senator Dixon.

Senator **Dixon**. Thank you, Mr. Chairman.

HOUSING NEEDS IN DADE COUNTY

Mr. Adams, you testified, in the course of your statement a moment ago, about the housing needs in Dade County. I think you indicated there are 12,000 applications presently pending for public housing?

Mr. **Adams**. 28,000 for public housing. The 12,000 is for section 8.

Senator **Dixon**. Would you say that that condition is general for major urban areas in the country?

Mr. **Adams**. I think we probably have a higher number because of some special conditions.But most urban areas have very large waiting lists, at least equal to the number of units they manage. The wait is getting longer and longer.

Senator **Dixon**. In your capacity, do you have any figures available for the country generally?

Mr. **Adams**. NAHRO is doing a survey, that should be complete and analyzed within 2 to 3 weeks, which would go into the size of the waiting list.

Again, if the record could remain open, we would submit that information (see May 3 letter and accompanying data at page 432).

Senator **Dixon**. You indicated in your testimony you felt the need was $1.6 billion under the contemplated legislation, as distinguished from the request by Mr. Abrams in that department for $1.075 billion; is that correct?

Mr. **Adams**. Yes; take Dade County, we do not have any heating bills. There is no way that we can cut 10 percent on utility consumption, as HUD estimates.

One of the things that we have done, and a number of other housing authorities, with the concern over security and safety, we have upgraded the lighting of our sites, so that our senior citizens and our families are more secure. I do not think the private market has done that, and certainly not privately owned low-income housing.

We do not think that State and local government is going to be able to contribute one additional penney to supporting public housing. I think the administration has recognized that if the recommended rent increases that they are proposing are not adopted, then the figure is light. And we think the rent increases that they are proposing, in view of the conditions that now exist, would place a disproportionate burden on the low-income families and the elderly.

Senator **Dixon**. What is the difference, basically, the half billion dollar difference, between the position you take on behalf of your association and the Department's assertion, which some of us, including my colleague here, would question, that the $1.075 billion figure they use would constitute 100 percent response to the needs in the public housing sector?

Mr. **Adams**. The Secretary, for the fiscal year 1982 appropriation of $1.152 billion, has written to the Senate and the House, explaining how the Department feels, that that meets 100 percent of the need.

We have major disagreements with these assumptions. The Secretary has sent no assumptions to the Senate or the House as to how $1.075 billion meets 100 percent of needs. We would need to see what assumptions are made. We assume they would be comparable to the assumptions that were made for the fiscal year 1982 appropriation, and we think that is inadequate by several hundred million dollars.

Senator DIXON. I would appreciate having, when those are made available to you, the comparative analysis by your association with those of the Department concerning those differences that you might have with their assumptions.

Mr. ADAMS. When they are available, we will certainly do that. But the record may not be able to be kept open that long.

Senator DODD. If my colleague from Illinois would yield, we might ask you to expedite that, because our hope is, I think, Mr. Chairman, to move at some point, probably in less time than what you anticipated would be—that those figures would be available, those figures into a markup. So, if there is any way of moving along—it is a key question here. If there are some legitimate differences and they can be justified, then the quicker we know that, then the better off we will be in addressing that issue.

Senator DIXON. I want to share my colleague's view in that connection, Mr. Chairman.

I think before we come to an ultimate vote on markup, we ought to know what the differences of opinion are about the assumptions.

Senator LUGAR. The Chair would respond that it would be desirable.

I suppose the problem of the authorization appropriation budget process dictates that we have markups at certain points. So, certainly, we will earnestly all try to obtain information that would make the best judgment for the Senators possible.

Senator DIXON. I thank the Chair.

Senator LUGAR. Senator Dodd, would you like to continue?

Senator DODD. One more question for Mr. Abrams.

FOOD STAMPS

I would like to query you, if I could, on the administration's proposal to count the value of food stamps in determining income under the assisted housing programs.

My concern is that this proposal directly hits those that are least able to bear the burden of one of the basic necessities of life.

And if there is a social safety net, as we have heard discussed over the last year and 2 or 3 months, it seems to me with this proposal we are going to be tearing it apart.

Let me just share some data with you. I do not know if you agree with these figures or not. And if you don't, I would be curious as to what your figures are. But according to data that I am aware of anyway, the national figures, that one-third of the food stamp recipients in subsidized housing are elderly people. Over half of them are single-parent, female head-of-households. Eighty-three percent of the households in assisting housing with annual incomes below $3,000 receive food stamps.

Now, my point is this, since I do not see this change in HUD's original legislative submission, can you tell me—one, tell the committee where this proposal originated from?

And, two, since food stamps cannot be used, like cash payments or income, for just any purpose—and I fail to see any rationale for this change—I wonder what the magnitude of the rent increases under this proposal will be?

And can you tell us specifically what percentage of income would be available for other purposes and necessities of life in States with relatively welfare grants?

Mr. ABRAMS. That is the whole question? It is certainly a comprehensive question. Let me try and give you a comprehensive answer.

We have some people who are experts on the cost effects, and maybe they can join me at the table and assist me. But there is a very valid point brought out by Mr. Adams, when he raises the fact that there are 40,000 people on waiting lists at the Dade County Housing Authority. That is not necessarily an indication that there is not housing available in Dade County. It is an indication of the difference in expense to a low-income family between living in HUD-assisted housing and living in the private sector.

And you know the limitations on rent which the gentleman from Indiana suggested should be waived—Mr. McLean suggested should be waived—that type of suggestion would require you to repeal the Brooke amendment in order to allow them to set rents on a minimum rent level or allow them to not provide for the personal benefit expense level.

Now that whole scenario is important to understand, because in a country that does not have a housing crisis and that does not have a shortage of rental units, the waiting lists are indicative of exactly how much better off low-income tenants in HUD-subsidized housing are than those people in the private sector. And that is a national judgment, that the people we are assisting should be at that level.

The other foot, or the other shoe, is that those families in the private sector have to look at all of their income, whether it is cash income, food stamp income, or whatever other income they get. And when they determine how much they can spend for housing in the private sector—and many of them, unfortunately, spend over 50 percent, some up to 80 percent of their income, including food stamps, for shelter. And that is not a healthy situation.

And neither the Department nor the administration thinks that that is a healthy situation. That is why we are trying to come up with programs that will allow us to help more families, for less cost per family, through the use of certificates.

For people in the real world, outside of HUD programs, food stamps are the same income as is cash payments whether it is from employment or from AFDC or for some other supplemental income. The relationship between the amount of food stamp income and the amount of welfare payments are inversely proportional. In States that have low welfare payments, the amount of food stamp payments goes up, and so in not counting food stamps you are being unfair to people who come from higher welfare States and therefore have to pay more rent, than people who come from low welfare States that therefore get high food stamps.

As far as where the initiative has come from, the initiative is being made by the Department of Agriculture to remove the statutory limitations on counting food stamps as income. The magnitude of the increases—can anybody help me?

Senator Dodd. Mr. Abrams, there is an assumption, an implicit assumption in your last several sentences that somehow if we increase the burden of those under the assisted housing programs, we are going to ease the burden of those who are not under the program.

Mr. Abrams. I did not say that. I said that the administration views the burden on low-income families who are outside the programs as not being acceptable.

Senator Dodd. How is that going to help them, by increasing the burden of those under the program?

Mr. Abrams. First of all, I was explaining why there is such a high waiting list for HUD programs. I was also explaining to you how you get to an unfair equation when you do not count food stamps, which in the real world is as much income as is cash——

Senator Dodd. It is unfair, in a sense, unfair in the fact that we are not able to do everything we would like for everybody.

Mr. Abrams. I agree with you.

Senator Dodd. But for those who are covered presently under assisted housing programs, as I mentioned to you, and I do not know if you disagree with my statistics, the ones I cited about the numbers, of one-third of them being elderly people, half of them being people who come from single family female-headed households, and 83 percent of them you have got was people who are living at below the poverty level. Now, I will grant you, I am upset and worried about those people who we cannot, unfortunately, get into these programs, but if we are going to realistically deal with these people who legitimately are covered under these programs right now, and you are going to take a food stamp program—whatever other problems it might have—and decide that you are now going to consider that as a part of their income and determine their subsidy, it seems to me we are adding a burden to people living on fixed incomes, be they elderly, or people who are living at that poverty level or below. I do not quite understand the justification for doing that. It seems self-defeating if, in fact, we are trying to help those least able to help themselves.

Mr. Abrams. I will reiterate that food stamps to people in the real world who are not in HUD assisted programs is the same and has the same effect as cash payments, and in States that have low welfare payments they have high food stamp payments. It is equally unfair to people from Boston where they have high welfare payments and low food stamp payments, to ask them to pay more rent than people in San Antonio where they have low welfare payments and high food stamp payments.

Let me introduce Ms. O'Connor, the acting deputy assistant secretary for policy development, and she can give you first-hand information on the statistics.

STATISTICS ON FOOD STAMPS

Ms. O'Connor. The March 1980 Census Current Population Survey estimated that about 17 percent of all food stamp recipients, or about 3.9 million households, had an elderly head. This means that about 24 percent of all food stamp recipient households have an elderly head. Benefits for the elderly are relatively much lower than for the nonelderly, primarily because the SSI program assures a minimum income standard which is considerably above the income level of many very low income nonelderly food stamp recipients.

About 15 percent of all HUD-assisted households have elderly heads and receive food stamp benefits. Actual impacts from counting food stamps as income will vary greatly depending on household size and income. Those most affected will be very low income households with low cash incomes but high food stamp benefits.

To give you a few examples which we have calculated on, for example, the first year rent increases, you have to recall that we are proposing a 20-percent cap on rent increases as a result of the inclusion of food stamps, so that the number which is calculated has to consider that phasing. For the national average, the food stamp benefits for a four-person household, that is a single family, single head of household with three children, the monthly benefit is $156. When you consider the 1981 amendments phasing in, plus our change, the net rent increase in the first year of our proposal would be $14 a month, as a result of counting food stamps.

That does vary across the country, as Mr. Abrams indicated. That first year impact in Atlanta would be $6 a month, in Detroit $23 and in Los Angeles, $25, and in San Antonio where the food stamp benefit is very high but the current rent is only $14, the increase per month would be $5. That is in the first year. Later on it goes up on a 20-percent basis.

Senator Dodd. What are your figures for the second, third, and fourth year?

Ms. O'Connor. I have estimates of the net difference after full phasein, but I do not have the incremental annual increases.

Senator Dodd. What does that figure work out to be?

Ms. O'Connor. In the full phasein it would be an increase of $47 a month nationally. That would probably occur over about a 4- to 5-year period.

Senator Dodd. That is off the base rent?

Ms. O'Connor. In addition to the base rent which—well, let me put it the other way. The rent, under the full phasein of the 1981 amendments, is $72. The rent, counting food stamps, full phasein is $119.

Senator Dodd. Run that by me again. The $119 is what figure? That is the total increase?

Ms. O'Connor. That is the monthly rent—national average monthly rent after full phasein of the food stamp calculation.

Senator Dodd. Which would be 4 years?

Ms. O'Connor. It is a rolling 20 percent which changes each year.

Senator Dodd. What is the base right now, national base figure?

Ms. O'Connor. The full—the reason I am hesitating is that we have 1981 amendments changes which are phasing in automatically as to the law, and now we are adding another change to that so the calculation is driven by two different forces.

Senator Dodd. What was the 1981 base, since that is the year we start both of these?

Ms. O'Connor. Under 1981, full phase would be $72.

Senator Dodd. The base, not the phasein. What are we starting with?

Ms. O'Connor. $68.

Senator Dodd. $68. And we are going to now increase it over 5 years $119?

Ms. O'Connor. No, to $119.

Senator Dodd. So it is about a 100-percent increase.

Ms. O'Connor. Over a 5-year period.

Senator Dodd. What do you anticipate increases to be for people in that category, the recipients. Do you think they will increase about 100-percent in 5 years?

Ms. O'Connor. Well, we are talking about a family with AFDC.

Senator Dodd. What are the likely increases to be in AFDC.

Ms. O'Connor. I think I will defer on that.

Senator Dodd. You do not think they would be 100 percent, do you?

Ms. O'Connor. Well, the point of this is we are taking into account the food stamp benefits.

Senator Dodd. I know that.

Ms. O'Connor. We are understanding that they have that additional income to pay for essential family needs.

Senator Dodd. Include that as part of their income.

Ms. O'Connor. Yes.

Senator Dodd. In this determination. My point, Mr. Abrams, do we anticipate a 100-percent increase in AFDC payments?

Mr. Abrams. I do not think this anticipates increases in AFDC payments. It anticipates an increase in the amount of rent because of a treatment of all income to the family, rather than just selected income to the family.

Senator Dodd. Just one more here. I am told that the department is considering regulations to eliminate certain deductions, additional deductions from income for the purposes of establishing income for eligibility and rent contribution under the assisted housing programs. One, is that the case? And two, what is the legislative authority for that?

Mr. Abrams. We have two rules——

Senator Dodd. And three, what are the ones you are considering?

Mr. Abrams. We have two rules that are in clearance right now. The first one implements the statutory increases in rents and tracks the statute, and it will be an interim rule, and I think it is—its promulgation is imminent, at least it should be coming to you shortly, if it has not already.

The second rule defines eligibility and deductions in determining what adjusted income is. There are several adjustments that are maintained in there from prior regulations. The final rule has not been worked out, and when it is we will be happy to talk to you about what is included and what is not included in our proposal before you render a judgment on it.

Senator DODD. What is your statutory authority for that?

Mr. ABRAMS. The statutory authority is that the Secretary is supposed to adjust the income. There are three different bases for determining rent: 30 percent of adjusted income, those adjustments determined by the Secretary; 10 percent of gross; or the welfare rent in those States that segregate shelter payments when they pay out welfare from other payments.

Senator DODD. And the deductions from income, which is also what you are considering?

Mr. ABRAMS. I said one of the criteria is 30 percent of adjusted income, and the adjustments ought to be determined by the Secretary in the statute.

Senator DODD. I think that is debatable. But anyway, how soon do you anticipate to have those?

Mr. ABRAMS. We hope within 30 days.

Senator DODD. Again, we're going to have a problem with 30 days, Mr. Chairman. We're talking about markup in a couple of weeks, aren't we?

Mr. ABRAMS. That does not affect the budget, I don't believe, the adjustments to income.

Senator DODD. Have you asked Dave Stockman that?

Mr. ABRAMS. I do not consult him on policy decisions that involve adjustments to income as how they affect the budget, but the amount of income in the adjustments will be put forward in regulations that will come to the Senate and the House and you will have a chance to review what we are proposing and tell us whether you agree with us or not.

Senator DODD. Thank you.

Thank you, Mr. Chairman.

Senator LUGAR. Thank you very much, Senator Dodd. I will ask just a one quick question.

TWO-TIER SYSTEM

We have had some testimony in prior hearings that the problems faced by the larger housing authorities are substantially different than those faced by the smaller authorities. There are many reasons for this, and I will not try to review those, but a two-tier system was suggested by some witnesses, with many of the smaller housing authorities believing—and I think Mr. McLean testified in general in this direction today, that with certain adjustments, they would be able to make substantial difference in the amount of subsidy that is needed for them. That feeling did not come forward from the larger housing authorities who felt that special problems would prevent that.

What is the feeling of any of the three of you or all of the three of you about a two-tier approach? Are there maybe 100 large housing authorities that ought to be treated in a separate category, realistically, with maybe many hundreds that would be treated in a different way?

Mr. ABRAMS. If I can react, I could not agree with that suggestion more. That has come through very clearly in every aspect of the relationship between HUD and the public housing authorities, that there are two different public housing authority systems in this country. There is one that involves large housing authorities in major cities and there is one that involves small housing authorities.

Where to draw the dividing line is going to take the judgment of a Solomon, but in deregulating and drawing the new regulations for public housing management, we have tried to react to that dichotomy between the two systems to allow the HUD area offices to develop different types of procedures with housing authorities that fall into one class or another, or the other class, in terms of—because it is our perception that in probably 2,000 of the housing authorities, or 2,600 out of the 2,800, HUD can be more of the problem than the solution. And the further we get HUD out of the management of those 2,600 housing authorities, the better off everybody, including the tenants, are going to be.

Whether it is 50 or 200 that are in the other category, it is our feeling that HUD and the housing authorities are going to have to do a lot of work together to improve the management of some of those housing authorities and the safe and decent condition of the housing that we are jointly responsible for providing.

Senator LUGAR. Mr. Adams, do you have a thought about this?

Mr. ADAMS. I agree with Mr. Abrams. I think where you draw the line, though, is complicated and how you draw the line, because there are certain national interests, whether you are a small or large. That national interest has to be protected. It is a direction that HUD ought to proceed in, and then let—obviously they would—the Congress and the affected authorities review what they come up with.

There are small housing authorities that have great fiscal problems. There are large housing authorities that are financially well run, and the more you can create individual conditions individually, the better we are. But it is easy to say it and tougher to do it.

Senator LUGAR. Mr. McLean?

Mr. MCLEAN. I disagree with him. Eight years ago, when I took over the New Albany Housing Authority, we ran between 35 to 38 percent delinquency. Today we are running less than 8 percent. Through hard work and eviction, we get the job done. These people are saying that whether people live in the New Albany Housing Authority, Minneapolis or wherever, it is how strong management wants to get with them, get the eviction procedures and set up the guidelines to go by and how strongly they want to implement them.

I think once you get that established by your bigger authorities, they would be just the same as the authority of 200, we have right now around 1,100 units. That is not a large one. But for a small town, we have some of the same problems. We have vandalism. I came there 8 years ago. Our vandalism was running $10,000 to $12,000 a year. Last year it ran less than 300.

So, it can be done if you want to get the guidelines and draw a straight line, and everybody has to adhere to the same rules.

Senator LUGAR. Gentlemen, we thank you very much for coming this morning. It has been a most informative panel. Did you have any more questions? Senator Dixon?

Senator **Dixon**. If I might ask one more question, Mr. Chairman, I am intrigued by this whole policy decision. If the young lady could help me just a moment? I did not catch your name.

Ms. **O'Connor**. O'Connor. Feather O'Connor.

Senator **Dixon**. I appreciate your letting me pursue one more time with you. As I understand, the policy will be to increase in stages over 4 or 5 years the basic rate from $68 to $119?

Ms. **O'Connor**. I was quoting a national average for a four-person household with AFDC income. The reason the number of years is between four and five is because each year there is a cap of a 20 percent increase, but the 20 percent is on a rising base income and therefore it phases in at a different period. In general, it would be over a 4- to 5-year period.

Senator **Dixon**. It would rise from $68 to $119 over a 4- to 5-year period?

Ms. **O'Connor**. That is correct.

Senator **Dixon**. And you will include food stamps in the total evaluation?

Ms. **O'Connor**. No. Excuse me. The counting of food stamps is the cause of the increase. In other words, we are counting food stamps as income and increasing the rent as a result of changing the base, but we are doing it in phases.

Senator **Dixon**. That is the triggering factor that causes what transpires?

Ms. **O'Connor**. Yes. It is not in addition to that.

Senator **Dixon**. Of course, the payment of the rent cannot be made with food stamps. In effect, you are taking more dollars out of the dollars left over and above food stamps. You cannot use the food stamps to pay the rent. You are reducing the dollars that the person has independent of the food stamps; is that correct?

Ms. **O'Connor**. That is correct, but of course the person receiving food stamps has a lesser need for income to buy food because they are using food stamps. So it is a reciprocal——

Senator **Dixon**. But the dollars the person had prior to this policy decision, in addition to the food stamps, were *x* amount of dollars that will now be reduced by calculating food stamps in the formula. This is true, is it not? And then the administration has another bill in to further cut food stamps this year, as I understand it. Is that correct?

Mr. **Abrams**. I am not familiar with that.

Senator **Dixon**. I think it is fact. I just want to say that that will be very interesting when all of these policy decisions are applied at the level of the very poor people in this country.

Thank you, Mr. Chairman.

Senator **Lugar**. I thank you, Senator Dixon. Thank you, panel, for your testimony. The Chair would like to now call the Honorable George Latimer, mayor of St. Paul, Minn., on behalf of the National League of Cities, U.S. Conference of Mayors; and John Ritchie, executive director, Virginia Housing Authority.

STATEMENT OF GEORGE LATIMER, MAYOR OF ST. PAUL, MINN., ON BEHALF OF THE NATIONAL LEAGUE OF CITIES AND THE U.S. CONFERENCE OF MAYORS

Senator **Lugar**. Gentlemen, we welcome you. Hopefully, Hon. Jim Scott, supervisor of Fairfax County, Va., representing the National Association of Counties, will join you during this period. He is late.

So we will proceed with this panel as is, and I would like to call upon you, first of all, Mayor Latimer, for your testimony.

Mayor **Latimer**. Thank you, Mr. Chairman and members of the committee. It is always a great honor to appear before this committee. I am here today as mayor of the city of St. Paul, the second vice president of the National League of Cities, and also as chair of the Community Development Housing and Economic Development Committee for the United States Conference of Mayors.

Because much of your testimony today and before this, Mr. Chairman, has dealt with the macrocosm and the larger national figures, I will try to relate those to my experience as a mayor, and I will constrain myself to the 5 minutes suggested by the chairman, or mandated, I should say, by the chairman.

First of all, Mr. Chairman, a brief word about St. Paul. We are about 270,000 people today, about 20,000 down from 10 years ago, and the population has pretty much stabilized at that. We have a total of just under 110,000 housing units. We have been very aggressive in an all-incomes housing policy over the past 5 or 6 years, increasing by rehabilitation and by new construction a total of about 7,000 new housing units in combination during the past 10 years.

We have done that by using the variety of tools, many of which were available because of the Congress and legislation provided. A whole mix of leveraging section 8 is one example. We have used our section 8, new construction, in almost every instance possible, wherever more than 50 or 40 section 8 units were used. We would use it to leverage 200 or so of market rate housing units.

As a consequence, we have 250 new construction section 8 units. We have created 1,000 total new housing units in the city of St. Paul.

In addition to that, in our public housing, Mr. Chairman, we have a total population of about 12,000 people. Two-thirds of those people are large family poor, pretty much like the national pattern. The average income is well below 50 percent of median.

I do not think this committee or the chair needs any elaboration of the fact that, subject to the present market, or any past market we know of, these people were simply out of the market as far as shelter is concerned. We have a waiting list of about 2½ years for our family housing, a total number of families of about 1,000. Of those, 750 are large family, and the rest are elderly.

Finally, I should point out that we have about 10,000 refugees, Hmong refugees, and they represent about 80 percent of the waiting list right now for public housing.

POSITION OF PROGRAMMATIC RECOMMENDATIONS

And now, in the remaining 2 or 3 minutes, I would like to touch on the conference and the league's position on the various programmatic recommendations of the administration in its fiscal year 1983 budget. We think from a leveraging standpoint, the evidence that we have so far on those cities who have been using section 108—the evidence is very favorable. Quite clearly, it is not the same kind of budgetary effect of many of the other programs, and therefore we seriously question the recommendation to abolish that.

And, I offer—and I should have done this at this at the outset—I offer the printed statement which I will not read and all of the five or six attachments, which include, Mr. Chairman, the survey which shows 23 respondents reported a total of 20,000 new jobs either created or retained through section 108. I submit testimony and the survey at this time, Mr. Chairman.

Senator LUGAR. Thank you.

[The complete statement follows:]

STATEMENT OF THE HONORABLE GEORGE LATIMER

MAYOR OF THE CITY OF ST. PAUL, MN.

on behalf of

THE UNITED STATES CONFERENCE OF MAYORS

and the

NATIONAL LEAGUE OF CITIES

Mr. Chairman, members of the Subcommittee, thank you for the opportunity to testify this morning. My name is George Latimer. I am the Mayor of St. Paul, Minnesota, and I am testifying today on behalf of my city; the U.S. Conference of Mayors, where I serve as Chairman of the Standing Committee on Community Development, Housing, and Economic Development; and the National League of Cities, where I serve as Second Vice-President. Let me say, Mr. Chairman, that it is a particular pleasure to join you today to share our views with a distinguished colleague whose understanding of local government's problems and prospects is so well-known.

Since FY81, total grants to state and local governments have declined from $105.8 billion in the FY81 budget to a projected level of $65.1 billion in FY83 under the proposals forwarded by the President in early February. The total cut in state and local assistance enacted by Congress and proposed by the Administration is nearly $50 billion--a significant scaling back of the federal government's commitment to cities and to urban residents and businesses. Again, this year, the Administration is demanding the cities assume new responsibilities out of existing programs--such as the Community Development Block Grant (CDBG) program--and with less overall resources. Further, the people who desperately need help from these federal programs are being told to look to local and state governments, which threatens to compound the human and budget problems facing cities. The result will be increases in property and other local taxes, additional layoffs and service cuts at the local level, as well as deferred maintenance of critical public infrastructure.

Last November, the Conference of Mayors conducted a 100-city survey to assess the impact that enacted budget cuts in FY82 were having on local governments. Briefly, we found that 41 percent of the surveyed communities have already or shortly plan to raise local taxes to try to recoup losses in federal funds. Sixty-one percent indicated that they already have or plan to scale back staff and services in response to the cuts.

The outcome locally is the same--increased tax burdens through the most regressive possible means, such as sales and property taxes, and decreased services to populations in genuine need.

I would like briefly to address the details of the Administration's budget and legislative proposals, and highlight a few specific problems cities face in the authorization process before the Subcommittee If I may, Mr. Chairman, I would like to submit for the record the National League of Cities' priorities for 1982, adopted recently by our Board of Directors.

Community Development

The Administration's FY83 budget request for $3.456 billion for Community Development Block Grants (CDBG) is a disappointment. The National League of Cities and Conference of Mayors support the fully authorized level of $3.66 billion set by this Subcommittee last year, although we note that this is substantially below the levels anticipated in the Housing and Community Development Act of 1980.

We oppose completely the Administration's proposal to eliminate the Section 108 Loan Guarantee program. This is a valuable tool for communities to use in economic development work. The Conference of Mayors has conducted a special survey of Section 108 program participants. I would like to submit this for the record at this point. Briefly, the survey shows that Section 108 loan guarantees are effective job producers. Our sample of 23 respondents reported a total of 20,072 jobs either created or retained through Section 108 projects. The average cost per job in the program was about $9,000 in guarantee authority. Leverage of private sector funds through the guarantee funds averaged $3.75 per federally guaranteed dollar. The League of Cities and Conference of Mayors believe that this program embodies the very elements of federalism which the Administration has promoted. Local governments assess their need for a Section 108 project. They issue the notes, which they are obligated to repay. The only federal role involves guaranteeing the funds, and, under HUD's regulations, using the Federal Financing Bank to purchase and resell the obligations. If the project is unsound, it is the local government, not the federal government, which must pay back the funds. Our survey shows that cities are using these funds to leverage private sector investment and create jobs. We urge the Subcommittee to provide at least $225 million in loan guarantee authority for this program in FY83.

St. Paul is one of eleven cities nationwide with Section 108 demonstration programs underway. At this time, we have three projects awaiting funding totalling $2 million in loans. All these projects involve loans for the purchase, renovation and expansion of existing businesses in St. Paul. I estimate that these three projects will result in the retention of 60-70 permanent jobs and the addition of 20-25 jobs for the City. Without the minimal downpayment and long-term features of Section 108 financing, these business expansions will not occur, since conventional financing is too expensive for small businesses under current market conditions.

The liquidation of all funds for the Section 312 rehabilitation loan program also is opposed by the Conference of Mayors and League of Cities. Especially at a time of such severe cuts in other urban programs, we cannot understand the logic of preventing paybacks to a revolving loan fund from being used to continue such a successful program.

In my own City of St. Paul, we have experienced a very high level of participation. Since 1975, over $8.9 million in Section 312 single family loans have been distributed providing rehabilitation of over 720 housing units. During 1981, only $162,300 was available to our City for single family loans. With so few funds available, we did not publicize the program. Yet we had over $1.2 million in eligible, unserved loan applications on file in the City's rehab office.

On the Section 312 multifamily side, my City has used over $3.8 million in funding since 1979, for the rehabilitation of 176 rental housing units. Again, during 1981 very limited funding was available resulting in multifamily loans of only $504,000 for four structures. My staff received applications totalling over $1.6 million for these 1981 dollars, with practically no publicity conducted on the availability of the program. Section 312 remains as one of the few resources available for rental rehabilitation loan programs. Therefore, the elimination of this program will particularly reduce the City's ability to preserve the City's stock of rental housing.

The Administration's request for the UDAG program also is a disappointment We hope that the Appropriations Committee will agree and provide full funding at the authorized level of $500 million for this program.

In St. Paul, again, UDAG has been a great success with thirteen grants totalling over $48.7 million, ranging in size from $565,000 to over $12 million. UDAG is a program which is extremely consistent with the Administration's direction because it provides a stimulus to the private economy with minimal governmental resources and involvement. The UDAG dollars which have been spent in my community have leveraged over 9 dollars of private investment for every UDAG dollar. Over 6,500 new permanent jobs were created as a direct result of UDAG-assisted projects at a public cost of $7,480 per job, and over 2800 new or rehabilitated housing units were provided. Net annual property taxes of over $8.9 million will be generated for the City from UDAG assisted developments. On balance, this program has directly contributed nearly one-half billion dollars in new investment for my community. And we do not intend to stop here.

Three additional projects are in the discussion or planning stage for application next quarter. Project planning for a development at University and Dale, one of the most notoriously blighted areas of St. Paul, holds promise for commercial strip revitalization. Multiple use development including renovation of a bank, conversion of a warehouse to housing units, neighborhood housing rehabilitation and supporting public improvements have been discussed by neighborhood groups and City staff for over a year.

A second project, very much in the preliminary stages, would provide a new development in the West Side community including a supermarket, neighborhood commercial development and supporting public improvements.

Finally, a third grant is anticipated for the Energy Park development in the Midway area of St. Paul. This redevelopment area, which stresses job growth with innovative energy conserving industries and businesses, has already received two UDAG's which have leveraged six individual projects. A third grant could serve to expand this concept with additional industrial/commercial development by extension of the public infrastructure.

Housing

The most severe blow to cities and to low- and moderate-income city dwellers in the Administration's budget request comes in its housing section. It represents a complete break with the last four decades of federal housing policy by requesting no additional funds for new housing assistance for low- and moderate-income persons. It would cannibalize past commitments funded by Congress, primarily to roll over thousands of units already subsidized under other programs. Despite the Administration's public statements in the past about reliance on "vouchers" to assist low- and moderate-income persons, the budget proposes to add only 30,000 vouchers for newly assisted households--all of these in conjunction with the Rental Rehabilitation Program. Another 10,000 units of

Section 202 housing for the elderly, and that is the Administration's proposed contribution to the terrible plight of lower income households in need of hosuing assistance.

Other witnesses will provide you with convincing statistics about the national need for housing assistance. Let me provide you some facts and figures from my own home town.

St. Paul has 4400 dwelling units of Public Housing in 4 projects, 235 scattered site dwellings and 16 elderly hi-rises under the control of a local Public Housing Authority (PHA) which is a seven member public board appointed by the Mayor with the approval of the City Council. Of these 4400 units, 2700 are for elderly residents and 1700 are for non-elderly families.

The current waiting list totals 900; 750 are families. This waiting list translates into a 2 1/2 year waiting period for a family to get into a Public Housing unit. Of the 750 families waiting for units, 500 are waiting for 3, 4 and 5 bedroom units. This statistic reflects the fact that Public Housing is the only source of housing for low income, large families. In order to expand the Public Housing stock for large families, our PHA has been purchasing older, single family dwellings scattered throughout the community. We now own and operate 235 units of scattered site housing to supplement the units in the projects.

The St. Paul Public Housing Agency also administers the Section 8 Existing Program, or certificate program. St. Paul has 1771 certificates in use at this time. Without an active publicity program, the current waiting list for these certificates is over 1000. This figure does not adequately measure true demand for the units, however, since applications are taken only once every few months with displacees and elderly applicants receiving priority.

Since the Administration's proposal contains no funding for development of additional Public Housing units, the demand/supply situation for low income housing units will not improve. Therefore, large low income families will continue to either over occupy available units or live in substandard units or pay rents far in excess of their ability to pay.

You might ask who are these people waiting to get into Public Housing units? Well, eighty percent of them in St. Paul are Hmong refugees. Eighty to ninety percent of them have incomes of 50% of area median income or less. For a family of four, this translates to less than $14,300 per year.

An example of a real family waiting to receive a housing unit is Family A, a single parent with two teenage children, waiting for a 2 bedroom unit in a project. The parent is employed and earns $5,675 a year. She is now paying $395/month for rent including utilities, which represents over 80% of family income.

Another example is Family B, a husband, wife and 5 children, waiting for a 4 bedroom unit. On AFDC, the family receives $501/month to live on. They are now paying $275 per month plus utilities for a three room apartment. Rent alone is over 54% of family income.

These are two examples of a total of 750 real families waiting for Public Housing assistance in St. Paul.

The condition of St. Paul's private housing market provides no hope for accommodating these needs. In the past five years, there has been no construction of moderately priced rental units in St. Paul without substantial public development subsidy. The vacancy rate for all housing during the last quarter of 1981 was 1.896%; 3% is considered adequate to allow some housing choice within the local market. The Metropolitan Council, which is a metropolitan-wide planning organization, develops statistics on vacancy rates and housing need in our area. This organization has estimated that there is an unmet renter need in St. Paul over 7,800 households. Given our best estimates of federal and state resources, which will be available in the near future, we will only be able to address 360 units of this need.

Clearly, given these statistics for St. Paul, the Administration's proposal for housing assistance is totally unacceptable and cuts deeply into the "safety net" for our nation's poor.

Mr. Chairman, let me put it bluntly. The Administration's budget request in housing is completely unacceptable to the National League of Cities and the Conference of Mayors. We need not agree on the best way to provide assistance in order to agree that there is a need for help. We are shocked by the Administration's proposal to add practically no additional units under Section 8 existing, even when the Administration has pointed to this as a successful and cost-effective vehicle in the past.

Last year the housing assistance budget was cut by the Congress from a $30 billion level in FY81 to just over $17 billion. The Administration would cut this even further in FY82, and actually produce a negative budget authority of about $2 billion in FY83. The Conference of Mayors and the League of Cities believes that no less than $17 billion should be allocated in FY83 for assisted housing. Holding the line this year against further cuts is the only equitable course to follow, when last year the brunt of the cutting fell on cities' budgets and most heavily in the housing area.

I have mentioned the need to augment the aid provided through Section 8 Existing Housing Certificates. The League and the Conference strongly believe that some federal program to assist in the development and rehabilitation of rental housing remains a critical need in many cities. The HUD Secretary himself has acknowledged that while there is no national shortage of rental housing units, severe imbalances do exist in particular markets. Mr. Chairman, nobody lives in a national housing market. We all live in local markets, and in mine and many others, severe needs for additional stock exist. The current economic situation--high operating costs, high interest rates, massive pent-up demand for homeownership--mitigate against private market participation in the rental housing market without some government assistance. We believe that it is critical for the Congress to develop a creative response to this problem in order to replace the Section 8 program which it is clearly going to cancel out this year.

In the last year, the Conference of Mayors and League of Cities have worked on a housing block grant approach for assisting rental housing production and rehabilitation. We have circulated copies of a draft program summary to the Subcommittee staff on several occasions. Briefly, our block grant would provide capital assistance on a formula basis to cities with a demonstrated need for rental housing assistance. These funds could be used in any program configuration favored by the recipient local or state government. Implicit in the program's design would be an accompanying "voucher" program like the current Section 8 Existing Housing Certificates to provide the necessary ongoing subsidy for tenants to assure their ability to pay for decent housing at a reasonable cost. Our proposal has much in common with S. 2171, introduced by Senator Dodd of this Subcommittee. Like our proposal, his would provide assistance directly to state and local governments for the purpose of encouraging rental housing production and preservation. Like ours, his proposal would encourage innovation and highly leveraged use of funds. Like ours, there would be a requirement to provide units for low- and moderate-income families with the funds, although not for every unit.

Clearly, there are differences between the two approaches. The most obvious is that under our approach, there would be a formula allocation of assistance which cities could count on, and plan on. At the same time, such a formula allocation demands a very considerable commitment of funds. As we testified last year before this Subcommittee, a housing block grant insufficiently funded will be no boon to cities. The Dodd approach, with its competitive, UDAG-type system of funding, can be used with a lower level of funding, since all proposals must compete and no locality or state has an entitlement funding level. It cannot, however, form the basis of sensible long-term planning for housing development, and could be a disincentive to communities to develop sophisticated staff necessary to operate such a program without the assurance that funds to run a housing project will necessarily ensue from the application.

One possible modification to address this would be to combine the two approaches. States and local governments would apply for funds as in S. 2171 now. However, in doing so they would specify a housing development program over a period of time, say three years. HUD would provide, on the basis of a competition, awards of contract authority to carry out the approved programs, using a letter of credit arrangement like that used in CDBG. Localities awarded funds in this manner would not be able to reapply until they had completed the original program. Other communities thus would be encouraged to apply in subsequent years for similar awards. Using a system like this, regional allocations could be established based on rental housing needs. While all applications would be considered centrally by HUD, applicants would be seeking funds from their appropriate regional pot. This would ensure that all eligible parts of the country could compete fairly. In addition, the legislation could establish minimum and maximum standards for the number of units an application could seek. This would be a help to communities in guiding their own planning efforts. The advantage of a multi-year arrangement like this is that local governments would have an incentive to staff up for a steady program. HUD would be freed from hundreds of project by project approvals in one year. Use of the letter of credit would permit sound year to year budgeting of the program while protecting local governments from cancellations of program approvals caused by program fund reductions in subsequent years.

We look forward to working with the Subcommittee to help develop a sound initiative. Whatever the shape of your effort, we sincerely believe that the Congress must act this year to replace Section 8 with some kind of production/substantial rehabilitation support program to help communities faced with severe housing supply problems.

The Administration has proposed a small, Rental Rehabilitation Grant program for FY83. The proposal certainly has merit as one approach which many cities might find the most advantageous way to solve their housing problems. However the program is too restrictive. Many local governments would not place their primary housing emphasis on rehabilitation because their stock isn't suited to it. We oppose funding any housing initiative, especially one designed to replace all Section 8 development funds, out of the authorized CDBG amounts, as the Administration's bill suggests.

With the termination of Section 8, the Congress has a unique opportunity to shift the emphasis of planning and implementation for housing to local and state governments. We oppose doing so in a manner which would dictate a particular program approach to cities, as the Administration's proposal would. The Congress should adopt a program which is separately funded from CDBG, and which provides local and state governments with the widest possible discretion in designing appropriate programs to meet their local housing needs.

The Administration also has proposed substantial modifications to the Section 8 Existing Housing program. We urge the Congress to withhold approval of these changes until a thorough study can be made of their likely effects in different housing markets. I would like to submit for the record a copy of a study undertaken by the City of Seattle showing how these changes would effect its current Section 8 existing housing population. The Pratt Center in New York also has published a similar study, which has been made available to the Subcommittee. If the findings of these two studies are borne out on a large scale, then the modifications are likely to impose substantial increases in rent burden for some Section 8 assisted tenants.

These increases will be exacerbated by the Administration's proposal to count food stamps as income in the assisted housing programs. The League of Cities and Conference of Mayors urges you to oppose this proposal as vigorously as you can. It will hit the very poorest of the poor the hardest. Rents in some instances could be doubled overnight as a result of the proposed changes. This is no way to preserve a safety net for the truly needy, and we hope you will oppose it.

Public Housing

The Adminsitration's proposals in public housing concern us greatly. First, the amounts proposed for public housing operating subsidies in FY83 are completely inadequate. HUD's own internal estimates show a need for $1.6 billion next year, yet the Administration requests only a little over $1 billion. The Administration's modernization proposals would force local governments and PHAs to choose between completing new construction projects which were approved in prior years, and taking back half those funds for modernization. Many of these units are needed desperately in cities. The projects have been under development for years, in some cases. To force cities to choose between meeting these real needs and modernizing existing stock is a cruel choice which only shreds the social safety net that much more. We believe local governments and PHAs should have the option to convert development funding to modernization funding, as provided in last year's authorization. But we oppose strongly making this the primary source of all modernization funding in the program as the Administration's bill would.

St. Paul's Public Housing represents a total public investment of over $1000,000,000. Yet the Administration's proposal places this valuable investment in jeopardy by proposing for FY82 that the St. Paul PHA submit an operating budget to HUD reflecting a subsidy cut of $1,000,000, of a total operating budget of $7,400,000.

A reduction of $1 million from a full federal subsidy level of $3 million represents a cut of 33% for FY82. Fortunately, St. Paul's PHA may be able to recover the $1 million loss for FY82 from operating reserves at the end of this fiscal year, if reserves are available. However, discussions with the Administration indicate another cut for FY83 of 25-33%, which could mean another $1 million cut for St. Paul. Continued cuts of this magnitude cannot be sustained without substantial deterioration of the housing stock.

Cost cutting measures already instituted in St. Paul include:

- The loss of 31 positions, 18 administrative and 13 maintenance, of a 200 total.
- The reexamination of elderly residents' income every year instead of once every two years.
- The elimination of certain maintenance services and paid laundries in elderly buildings.
- The deferral of maintenance on scattered site family units.

The consequences of continued reductions in operating subsidies will result in the need to sell off the scattered site units for private rehab or, in extreme cases, demolition, since these are the most costly units to operate and maintain. Unfortunately, scattered site units are the most in demand for larger families.

St. Paul receives $1 million annually for modernization of Public Housing. The Administration proposal would maintain this level over FY82 and FY83. Comprehensive improvement Assistance Program (C.I.A.P.) is the HUD mechanism by which these funds are distributed which requires targeting of modernization funds to a specific project each year. Therefore, none of these funds can be used for the "scattered site" homes. If modernization funding is not increased or cannot be used on a locally determined basis, then more pressure will grow to sell or demolish these much needed units, because deterioration will escalate.

The Administration also would liberalize the terms under which existing public housing could be demolished or converted to other uses. One feature of this proposal would override the local government and tenant consultation requirements of the modernization program. The National League of Cities and the Conference of Mayors strongly object to this override. Especially when demolition of existing public housing resources is contemplated, it is essential that local governments and tenants have a role. The decision to demolish property should not be viewed in the same light as modernization improvements needed to correct fire hazards,which is the principal reason under the modernization program for overriding the consultative process.

Other Issues

Finally, Mr. Chariman, I would like to raise a few issues which are of particular concern to us. The first is the effect of the Administration's budget proposals in FY82 and FY83 on the ability of communities to complete a variety of program initiatives they undertook in previous years with the understanding that Section 8 funds for new construction or substantial rehabilitation would be available. First and foremost among these is the Section 8 Neighborhood Strategy Area (NSA) program. Begun in FY79, this demonstration program provided local governments with allocation and preliminary processing authority over specific amounts of Section 8 Substantial Rehabilitation authority. The program was run as a national competition. All participating jurisdictions were required to develop a comprehensive five-year plan for a specific targetted neighborhood in which the units would be used. HUD, in turn, agreed to provide an agreed-upon number of Section 8 Sub Rehab reservations during the five-year demonstration period.

In January and February of 1982, the Conference of Mayors staff undertook a survey of all participating jurisdictions in the NSA program to find out how many Section 8 units these communities had expected to reserve in FY82 and FY83. I would like to submit the report of this survey for the record at this point. The survey revealed that 46 of the communities surveyed anticipated reserving a total of 4,249 Section 8 units in FY82, and 18 communities expected to reserve an additional 1,324 units in FY83.

HUD's budget proposals for FY82 and FY83 would cancel out the Section 8 program, and leave these communities high and dry. All of the participating jurisdictions were required as a condition of joining the demonstration to develop comprehensive CD plans for their areas. Many undertook significant investments in these areas in anticipation of the Section 8 reservations. HUD's regulations also required a high degree of citizen participation in the NSA process. Many communities negotiated agreements with neighborhood groups and citizens which they will be forced to break if the Section 8 units are not provided as promised. Many communities have worked closely with building owners and new developers, many of whom have invested their own funds in anticipation of participation in the Section 8 program. Their investments also will be lost if HUD has its way.

St. Paul is now working with the Minnesota Housing Finance Agency to make 83 units of NSA Section 8 housing financially feasible (1981, 1980, 1979 allocations). High tax exempt interest rates (13.5-15%) and inadequate fair market rents have made existing HUD Section 8 allocations unworkable. Through the use of local funds (CDBG) and private contributions from the Minneapolis/St. Paul Family Housing Fund, in the form of equity participation loans, the MHFA interest rates will be written-down to make these projects feasible. However, the total local subsidy per unit will be very expensive - $7,500 - $12,000 per unit - which demonstrates St. Paul's commitment to proceed with programs to expand the supply of low income housing.

If funding for the FAF (currently workable at 12% tax exempt rates) was increased to work at 13%, these projects could go forward with a greatly reduced level of local assistance, because the MHFA recently sold bonds for these 83 units at 13 5/8%.

There are other, similar examples: communities which are under a court-ordered settlement to provide opportunities for lower income housing to comply with CDBG requirements and expected to fulfill these obligations using Section 8; communities under administrative settlements with HUD for the same reasons; communities which undertook CDBG investments to prepare for lower income housing simply as part of a comprehensive CDBG strategy; and communities which used Section 108 loan guarantee authority to purchase land for housing development some or all of which was intended for Section 8.

The Subcommittee must examine these "overhang" issues closely. If HUD has not provided any firm estimates of these overhangs to Congress to date, we urge you to request such an estimate to gauge the effect of the Administration's proposed termination of Section 8. We urge the Subcommittee to consider language which would require the Secretary to set aside sufficient authority to meet these commitments in FY82 and FY83. The Conference of Mayors and other state and local government groups have undertaken a survey of CDBG recipients in an attempt to gauge the magnitude of this overhang and will share the results with the Subcommittee when it is completed.

In closing, Mr. Chairman, let me stress our concern that the Subcommittee consider the entire range of housing issues now facing the country and adopt a comprehensive approach to attacking them. We all can agree that budget concerns are critical to the country at this time. We believe that cities and the needy people who live in them have taken more than their fair share of cuts in the last year. It is absolutely critical that this Subcommittee and the Congress generally exercise leadership to set priorities within the budget on the programs you oversee. We believe this requires that all the problems in these areas be addressed in a comphrensive piece of legislation, so that the relative costs of the different solutions offered can be considered and weighed against other, competing interests. In this regard, we are particularly sensitive to the pressure for homeownership assistance. The homebuilding industry is in crisis. It should be helped in some way. We are concerned, however, that in meeting this need, the Congress not foreclose its options to deal with other, equally critical needs, particularly those of lower income renters. Only by enacting comprehensive legislation can the Subcommittee help to forge the consensus on national housing policy which is so critical today. We are all suffering in the present economy, Mr. Chairman. The cities look to you and your colleagues to take the leadership necessary to make choices and balance needs in a way that can lead to consensus and support for housing policy.

Thank you for the opportunity to share our views with you today. I will be happy to answer any questions you may have at this time.

TABLES EXPLAINING ST. PAUL'S ACTIVITIES IN VARIOUS FEDERAL PROGRAMS

APPENDIX I

REHABILITATION PROGRAMS
1975-1981

PROGRAMS	PERIOD	FUNDS	DWELLING UNITS
CWR* Loans (CDBG)	1975-1981	$ 5,113,500	1,043
CWR Flexible (CDBG) and Deferred Loans (Formerly Grants)	1975-1981	5,962,100	1,526
MHFA** Loans	1976-1981	8,928,600	1,602
MHFA Grants	1976-1981	4,277,200	1,029
MHFA Rental Loans	1980-1981	347,000	75
MHFA Accessibility Grants	1981	130,500	18
CWR ITA Exterior Grants(CDBG)	1979-1981	244,700	214
Federal Section 312 Loans (Single Family)	1975-1981	8,926,300	726
Federal Section 312 Loans (Multifamily)	1979-1981	3,869,800	176
Sub-Totals		$37,799,700	6,409
BMHR Program***	1979-1981	21,129,500(1)	665
Totals		$58,929,200	7,074

(1) This figure represents only the rehabilitation amount financed by the BMHR Program; the entire Program provided $41.9 million for acquisition and rehabilitation mortgage financing.

* City Wide Rehabilitation
** Minnesota Housing Finance Agency
*** Below Market Home Rehabilitation Program
-local tax-exempt bond program
owner-occupied - 1-4 units rehab

UDAG SUMMARY (As of 4/2/82)

13 Grant Awards

Total Awards = $48,748,400

Total Private Investment Levered $443,251,926

Overall Leverage Ratio 9.1:1

Total New Housing 2,875 Units

Total Permanent New Jobs 6,517 ($68,014 private investment per job)
($ 7,480 UDAG funds per job)

Total Estimated Annual Net New Property Taxes $8,969,777

4/2/82

UDAG Breakdown

		Award Amount	Private Investment	New Permanent Jobs	New/Rehab Housing Units	Annual Net New Property Taxes
1.	Town Square	$ 4,800,000	$ 63,570,000	2,873	0	$ 1,123,405
2.	Brown & Bigelow	1,855,902	17,152,237	105	0	550,000
3.	East 7th Street	1,339,000	8,000,000	250	0	350,000
4.	Block 40	4,800,000	32,639,809	453	0	557,338
5.	Fort Road	2,500,000	14,825,000	267	120	297,131
6.	Energy Park	12,082,500	89,033,804	1,407	950	2,014,478
7.	St. Paul Hotel	2,860,000	18,233,800	400	0	450,000
8.	Family Housing	2,900,000	99,875,000	0	1,650	2,598,814
9.	District Heating	7,700,000	56,000,000	40	0	0
10.	Joint Energy	2,410,000	9,585,000	0	0	0
11.	Broadway Square	565,000	3,075,000	85	65	295,000
12.	Selby Avenue	1,505,000	8,762,526	142	90	100,520
13.	Energy Park II	3,431,000	22,500,000	495	0	633,088
	TOTAL	$48,748,400	$443,251,926	6,517	2,875	$ 8,969,774

NATIONAL LEAGUE OF CITIES PRIORITIES - 1982

(Adopted by NLC's Board of Directors February 28, 1982)

Overview

The Nation's cities enter 1982 facing severe financial problems. In 1981 Federal aid to states and local governments was sharply reduced, affecting cities directly and reducing the ability of state to provide needed assistance; high interest rates raised borrowing costs for all cities, forcing many to defer going to the market altogether; the national recession, which began in the late summer of 1981 and continues today, added to unemployment rolls and further reduced local revenues; and these problems became more severe at a time of growing agreement that our public infrastructure of roads, bridges, transit facilities, and water and sewerage works was in rapid decline, jeopardizing the national economic revitalization effort. This effort is also being undermined by the fact that too much of the Nation's human capital is unprepared to enter the job market, and that housing problems are now so widespread that they are a major deterrent to full economic recovery.

The President's FY 1983 budget continues the economic recovery program adopted last year; proceeds with large increases in defense spending and reductions in domestic program; and embarks upon an ambitious and comprehensive effort to reform the federal system through a sharp division of responsibilities between the national and state governments.

The National League of Cities continues to support the goals of revitalizing the Nation's economy and improving the operation and effectiveness of the federal intergovernmental system. We reaffirm our pledge to work with the Administration and the Congress to revive the Nation's economy and to assure a balanced and healthy federal system.

We believe, however, that certain policy changes are needed in 1982 if these goals are to be attained:

- First, to assure the success of the economic revitalization program, action must be taken to deal with the conflict between tight money policy and expansionary fiscal policy;

- Second, to enable states and local governments to maintain essential public infrastructure and services to their citizens, adequate resources must be made available to them; and

- Third, to strengthen the Nation's competitiveness in international markets, it is essential that a national employment policy be developed that includes investment in our human resources, consistent with our investment in physical plant and new technology.

Finally, we believe the President's federalism proposals deserve the most serious consideration. NLC is working with the Administration and Congress in developing the details of implementing legislation and plans to review and consider alternative federalism proposals and develop specific recommendations in this area at a special meeting of its Board of Directors in the near future.

The Economy

The combination of tax cuts, increases in defense spending, continued rapid growth of entitlement programs, and high interest rates is driving the federal budget deficit and the total national debt to dangerous levels. The projected deficits for Fiscal Years 1983-1985 insure continuing high interest rates that will make it extremely difficult to attain the strong economic recovery that is the goal of current policies. What the economy requires is a gradual but firm approach that reduces the deficit to levels that will avoid the conflict between economic recovery and tight money policies. To achieve this goal, NLC recommends the following policies:

Less Restrictive Monetary Policy. In 1981 monetary growth for the year as a whole was below the Federal Reserve Board's restrictive targets. A modest easing of monetary restraint may help to hasten the end of the current recession, aid ailing industries such as the automobile and housing industries, reduce federal borrowing costs, and provide needed help for essential local borrowings.

Additional Revenues. Additional revenues in Fiscal Years 1983-1985 will help substantially to reduce the budget deficit. We believe that Congress should suspend the 10 percent tax cut scheduled for July 1983 and decide early next year whether and to what extent economic conditions warrant its reinstatement. Furthermore, we urge Congress to eliminate wasteful and obsolete tax loopholes, including the selling of tax credits and the "all savers" certificate.

Slower Growth in Defense Spending. During Fiscal Years 1983-1985 defense spending is budgeted to increase by nearly 10 percent in real terms, following a substantial increase in FY 1982. Over a six-year period, Fiscal Year 1982-1987, three of every five new tax dollars will be needed to finance increases in defense spending. The share of the budget devoted to defense over this period will rise from about 28 percent in FY 1982 to 37 percent in FY 1987. In FY 1983, the increase in defense spending will exceed cuts in domestic programs by about one third.

NLC believes that such phenomenal growth in defense spending, a principal cause of budget deficits, must be modestly restrained and thoroughly scrutinized. We recommend that annual growth in defense spending be reduced to about 7 percent in real terms, an unprecedented rate of growth in peacetime, saving between $15 and 20 billion during the Fiscal Year 1983-85 period. Such modest reductions can be made without in any way endangering or jeopardizing the President's commitment to modernize our defense forces.

Slower Growth Instead of Cuts in Entitlement Spending. The budget proposes further reductions in entitlement programs, projecting cuts of $8.1 billion in the medicare, medicaid, food stamps, and AFDC programs. NLC believes that these additional cuts would place too heavy a burden on poor and working poor families. Programs which provide assistance to the poor, whether they are elderly, children, the disabled, or the long-term unemployed, should not bear a disproportionate share of funding reductions. Furthermore, such cuts should not create disincentives to work or impose new fiscal burdens on state and local governments. Instead, we urge a temporary reduction in cost-of-living adjustments for all entitlement programs indexed to the Consumer Price Index, through legislation providing for a 75 percent of CPI adjustment for such programs during Fiscal Years 1983-1985.

Human Capital Investment Program. A human capital investment program must be established as part of a strong national employment policy to develop the human capital potential of our Nation. Such a program should include employment training to address the remedial, job entry, job retraining, and displaced worker training needs of our people. The private sector, including both business and labor, must be direct partners in this effort. The Federal Government should provide effective incentives for the private sector to invest in efforts to address these training needs. Local governments are committed to fulfilling their responsibilities in this partnership.

Adoption of all of these policies relating to the economy would restore needed confidence in our economic policies by reducing budget deficits during Fiscal Years 1983-1985, thus permitting monetary policy to support and facilitate the Nation's economic recovery.

The Budget for Programs Affecting Cities

Federal aid to states and localities continues to decline sharply. If the President's FY 1983 budget is approved, federal grants will decline from $105.8 billion in FY 1981 to $65.2 billion in FY 1982. A large portion of this deep cut will be in programs that directly benefit cities and their residents. We believe that states and localities are bearing an unfair share of the burden of restraint in federal spending, and call for a moratorium on further cuts in state and local programs.

NLC commends the President for proposing to fund key urban programs -- general revenue sharing, community development block grants and UDAG, mass transit capital grants, and wastewater treatment construction grants -- at current FY 1982 levels. Depsite extremely difficult budget problems, the Administration has demonstrated an understanding of and commitment to the important services provided under these programs.

We are greatly concerned, however, over cuts proposed in other programs that directly affect those who can least afford reductions in services, and that are essential prerequisites for sustained economic growth:

- in housing for those of low and moderate income assisted by HUD's section 8 and public housing programs,

- in mass transit operating assistance which provides links to jobs and services particularly for those who do not or cannot operate automobiles,

- in highway assistance for cities which is critical for the development and maintenance of the infrastructure upon which the Nation's economic recovery depends,

- in CETA employment training programs for the unemployed and underemployed who need training in basic skills and retraining for better job opportunities; employment training programs should be funded at not less than current levels and funds should be allocated to units of general purpose local government through a national formula,

- in low income energy assistance which helps the poor cope with extraordinary increases in heating and cooling costs, and

- in social services programs, including programs serving refugees, which provide a wide range of important services for the neediest in our communities.

NLC is particularly concerned over the budget's treatment of environmental protection activities and the development of energy resouces. The statutory framework for environmental protection requires an effective EPA for research and development, national standard-setting, and enforcement activities. EPA's responsibilities in these areas are growing; yet it continues to fall behind in meeting statutory deadlines for standard-setting and in its enforcement responsibilities. States and cities lack the resources to take over these responsibilities. Therefore, EPA funding in FY 1983 should not be cut below FY 1982 levels.

We also believe that there must be a more balanced approach to meeting the Nation's energy needs at the lowest cost to consumers and businesses. The budget proposes sharp cuts in programs and business tax credits for conservation and renewable energy sources, while proposing increases or only modest reductions in commercial nuclear development and oil and gas development. Since conservation and renewable energy sources represent cost-effective approaches to solving our energy problems, NLC urges Congress to continue funding for programs in these areas at FY 1982 levels.

We urge the Congress to maintain funding for all of these important services and activities at FY 1982 levels.

The New Federalism

The National League of Cities believes that the President's proposal to restructure the federal system is a bold and significant initiative, the most far-reaching alteration of federal and state relationships since the New Deal. NLC plans to work with the Administration and the Congress in drafting specific proposals. To facilitate discussion, NLC urges the Administration and the Congress to consider the FY 1983 budget as separate and apart from consideration of the framework of the New Federalism proposal.

For local governments, this proposal entails both important benefits and serious risks. The benefits include a reasonable transition period which provides time for needed adjustments; guaranteed "pass throughs" of funds for direct federal-local programs for a specified period; and certainty of funding for major urban programs, such as general revenue sharing and community development block grants, again for a specified period.

At the same time, local governments could be subject to substantial risks during the latter half of the transition period and beyond. These risks involve primarily the treatment of local program needs by states after the initial guaranteed "pass through" period. We ask the Administration to actively consider the following questions which express municipal concerns. To what extent will states abandon local programs as a result of their own expanding state responsibilities? And to what extent will equitable state-local distribution formulas be developed after the termination of the federal programs to be turned back?

The proposal raises many other important questions: does it establish a proper division of governmental responsibilities in the area of income maintenance? should the Federal Government retain residual or shared responsibility in any of the programs being turned back? if state tax effort is to be relied on to finance certain program areas, should the proposal not address the problem of fiscal disparities among the states? should there be a requirement that states maintain a certain level of effort in key program areas? if, as may be inevitable, states will tend to deal with their own expanding responsibilities in the later years of the transition period, should not states be required to strengthen local tax and fiscal capacity to sustain an adequate and appropriate level of services? to what extent will the proposals merely substitute state bureaucracy for federal bureaucracy?

Some of these questions will be answered during the development of implementing legislation being prepared by the Administration; others by alternative proposals such as that recently recommended by Senator David Durenberger of Minnesota. It is clear that a full and vigorous discussion of all alternatives will be undertaken before a consensus can be reached.

NLC is working with the Administration on issues of concern to cities raised by the President's federalism proposal. After consideration by our policy committees, this Board will analyze the President's proposal, review and consider alternative proposals, and develop specific recommendations in this area at a special meeting to be held this spring.

Non-Budget Priorities

NLC urges reauthorization of the following major programs and activities that expire in 1982:

- the Comprehensive Training and Employment Act: retaining the existing prime sponsor system, with full participation of local elected officials, rather than the Administration's proposed block grant to states; increasing involvement of the private sector in providing training and determining jobs for which training is to be available; and maintaining current eligiblity criteria for training participants;
- the Voting Rights Act, as passed by the House of Representatives: extension for 10 years to insure elimination of governmental practices that have the effect of denying fundamental voting rights;
- the Clean Air Act: retaining essential provisions for protection of human health and all deadlines, sanctions, and emission control requirements;
- the Clean Water and Safe Drinking Water Acts: including establishing a groundwater protection strategy and new programs, such as a water bank to finance activities to protect and increase water supply;
- the Surface Transportation Act of 1978, providing aid for highways and mass transit programs, and the Airport Development Assistance Program for cities of all sizes, including consideration of higher aviation user fees; and
- the Public Works and Economic Development Act of 1965, providing economic development assistance to localities with high unemployment.

NLC urges enactment of effective fair housing enforcement amendments, an urban enterprise zone program, and support for technological innovation to improve productivity; and opposes federal laws and regulations that preempt state and local authority over cable services, hazardous materials, truck sizes and weights, and airport noise. In addition, we urge enactment of legislation to relieve municipalities from recent judicial decisions expanding municipal liability and subjecting municipalities to the anti-trust laws; municipalities should be specifically exempted from anti-trust laws.

SECTION 108 LOAN GUARANTEE:

A powerful economic development tool for cities

During March, 1982, the U.S. Conference of Mayors undertook a survey of all participants in the Section 108 Loan Guarantee program administered by HUD. The Section 108 program, authorized by the Housing and Community Development Act of 1974, is designed to provide locally controlled, long-term financing for selected economic and community development projects. Activities funded through Section 108 loan guarantees are expected to create jobs and increase local tax bases.

Applications for the loan guarantee can be made as part of the annual Community Development Block Grant (CDBG) proposal for a given year. If the guarantee is sought after the grant proposal has been submitted, it can be handled as an amendment. Only participants in the CDBG program are eligible to apply for loan guarantee commitments, and approved guarantees cannot exceed an amount equal to three times the applicant's annual CDBG grant amount.

Survey forms prepared by the staff of the U.S. Conference of Mayors were sent to every community which had received a Section 108 guarantee in prior years, as well as to those communities which have applications pending now at HUD. The purpose of the survey was to determine how Section 108 loan guarantees have been used in the past; how many jobs projects financed by Section 108 have produced or retained; and what effect on the local tax base the project had. In addition, the survey solicited suggestions for better design and administration of the program. The following sections summarize the survey responses received as of the end of March.

Program Participant Profile

A total of 23 jurisdictions responded to the survey by the end of March. According to the completed survey forms, these communities had CDBG entitlements totaling $215.2 million, and had received a total of 28 Section 108 loan guarantees totalling $187.9 million, for an average grant amount of $6.7 million. The loan amounts ranged from a high of $60.5 million to a low of $75,000. In addition, one city, Detroit, accounted for $141.7 million of the total loan guarantees in the sample, or 75 percent of the total. If Detroit is subtracted from the totals, the remaining 23 jurisdictions accounted for $46.2 million in guarantees, for an average of $1.65 million per loan guarantee in the survey, excluding Detroit.

Coordination with Other Resources

Twenty of the respondents stated that their Section 108 loan guarantees had been used in conjunction with other federal aid programs. Fifteen combined it with CDBG expenditures; four of these also used UDAG funds and one reported that it used the Section 108 loan guarantee in conjunction with CDBG, UDAG, and EDA funds. Another community reported combining the loan guarantee only with UDAG, and another with EDA and CDBG. One community reported combining Section 108 funds with public housing funds.

Fifteen of the respondents provided short descriptions of the projects these coordinated efforts funded. These included:

- setting up reserve funds for construction loans, site preparation, land clearance, and payment of front-end development costs;
- street improvements around land parcels assembled with Section 108 funds;
- to assist business development by offering alternative means of financing;
- to write down administrative costs in conjunction with a project.

Section 108 Loan Guarantee Activities

Communities in our sample have used Section 108 loan guarantees in diverse ways. Fourteen communities indicated that the guarantee funds would be used for economic development, mostly for new construction or rehabilitation of existing business structures. Five communities indicated they used the funds for rehabilitation or construction of housing. Three communities said they would use the loan guarantee funds for elimination of slums and blight, and land clearance. One of the surveyed communities indicated that it was using the funds for a facility to provide health services to local residents.

Job Creation through Section 108

All 23 responding communities indicated that jobs had been created or retained through the use of the Section 108 funds. Total jobs created in the survey sample equalled 20,072. Of these, 15,564 were newly created, while the balance, 4,399, were retained in existing businesses assisted with loan guarantee funds. (Detroit, which accounted for 75 percent of the total guarantee funds, only accounted for 6,700 of the jobs in the respondents' sample, or 33 percent of the total jobs reported.)

Taken together, these figures show that an average of 873 jobs were either retained or created with each loan guarantee. Also, the survey shows that in this sample, jobs were created or retained at an average loan guarantee cost of $9,359 per job.

The survey also showed that many of the jobs created through Section 108 available to low- and moderate-income persons. This ranged from a minimum of 20 percent to a high of 100 percent, depending on the community. Twelve of the survey respondents said that 50 percent or more of their jobs had been available for low0 and moderate-income persons.

Community Tax Base

Section 108 loan guarantees also have been used to augment local tax bases. A total of 22 of the responding communities indicated that their loan guarantees would increase their tax base. Taken together, these increases totalled $179.3 million of additional revenue to the communities, by their estimates. This increase came from combinations of property, sales, and license taxes collected as a result of Section 108 financed development.

Private Sector Leveraging

Twenty of the responding communities indicated that they had leveraged private sector investment as a result of the Section 108 loan guarantee. Total leveraged funds equalled $703.4 million, or an average of $3.75 in private funds for every dollar of funds guaranteed through Section 108.

Housing Production with Section 108

The survey also shows that Section 108 funds have been used to construct and rehabilitate housing. A total of 671 units were reported for new construction, of which 319 were rental units and 352 homeownership, while 86 units were listed for rehabilitation using guarantee funds. Most of the housing units were scheduled to be available to low- and moderate-income persons.

Current Problems with Section 108

Survey participants were asked to list any current problems they had or foresaw in the Section 108 program. Those who responded to this question included the following issues:

- high interest rates generally making all financing tougher;
- difficulties in negotiating with developers;
- uncertainty at the federal level, particularly after the November, 1981, termination of the program by administrative order.

Housing Commitments under Section 108

Survey participants were asked whether their loan guarantee projects had anticipated the use of federal housing subsidies, and whether proposals in the FY83 budget to terminate these programs would jeopardize those plans and the loan guarantee itself. Five of the respondents indicated they had used their loan guarantees to acquire and prepare land for housing, some of it subsidized through federal programs. Three of those respondents, as well as two additional communities indicated that suspension of the programs would jeopardize the loan guarantee program in their community.

Suggestions for Improving the Program

Survey participants were asked to suggest changes to the Section 108 loan program which they would recommend to improve it. Eleven of the respondents did so, and the most popular suggestion was to extend the repayment period on loans guaranteed by Section 108. Other suggestions included more flexible credit criteria; expansion of eligible activities; and designation of a particular Washington, D.C., HUD office staff person to coordinate the program and counsel participants. Many of those responding to the question simply noted that they felt Section 108 is a "good" program and should be kept on the books.

ANALYSIS OF PROPOSED CHANGES IN THE FEDERAL SECTION 8 EXISTING PROGRAM

SUMMARY

The President's FY 1983 budget proposes a dramatic shift in the way HUD provides housing assistance. The budget calls for the virtual elimination of new construction and rehabilitation programs in favor of a modified Section 8 Existing program. In FY '83 over 90 percent of all new direct rental housing assistance would be supplied through privately owned existing housing compared with less than 20 percent in FY '80.

The FY 1982 budget raised tenant contributions from 25 percent of income to 30 percent for all Section 8 programs. The FY '83 budget assumes a number of changes in the Section 8 Existing program itself. The program would no longer limit recipients to units with rents less than Fair Market rents. Recipients would live in any decent housing regardless of rent levels, but would receive a housing allowance based on a new rent standard. A number of other changes are designed to reduce the eligible populations and to increase the amount that program participants pay:

- requiring that food stamps be counted as income.
- reduction in program eligibility from 80 percent to 50 percent of median income.
- elimination of annual assistance increases increases to compensate for inflation in housing costs.

First year impacts of these changes on Seattle's program vary. The FY '82 increase in required tenant participation will be "phased in" over 5 years and the first year impact will be small. The elimination of Fair Market rents will actually benefit some Seattle recipients, those whose total housing costs are below the new rent standards. These gains would be more than offset by the change requiring food stamps to be counted as income and by the increase in tenant participation. The average decrease in housing assistance in the first year would be about $40 per month for each assisted household.

Longer term impacts are more difficult to predict. The elimination of annual increases in assistance to compensate for inflation will mean that the value of the assistance payment will be seriously eroded: Average monthly rents could increase by $100 to $200 over a five year period with no change in assistance.

Lanny Shuman
Office of Management and Budget
City of Seattle
April 1, 1982

The purpose of this paper is to explain the changes in HUD's Section 8 Existing program and how the changes will affect the Seattle area housing assistance recipients. The paper summarizes the changes in federal funding of housing programs; compares the current Section 8 Existing program with the proposed modified program; and quantifies the specific impacts of the program changes on Seattle recipients.

CHANGES IN FEDERAL HOUSING ASSISTANCE

The President's proposed FY1982 rescissions and FY 1983 budget shift federal housing efforts almost exclusively into assistance to tenants in existing housing, virtually eliminate the New Construction and Substantial Rehabilitation Programs (with the exception of the Section 8/202 program), and increase the amounts that housing assistance recipients must contribute toward their rents. The following table shows the changes in the major HUD housing programs from 1980 to 1983, and the proportion each program represents of total new federally assisted units for the year.

Numbers of Newly Assisted Housing Units Funded
by Major HUD Housing Programs - 1980-83

Program	FY80	FY81	Proposed FY82[1]	Proposed FY83
Section 8 Existing	47,022 19.6%	85,289 38.7%	186,385 84.8%	5,000 4.1%
Modified Section 8 Existing ("vouchers")	-	-	-	106,615[2] 87.7%
Section 8/202	20,440 8.5%	15,166 6.9%	16,933 7.7%	10,000 8.2%
Section 8 New Construction/Moderate Rehab	94,758 39.4%	58,69[illegible] 26.6%	5,569 2.5%	0 0.0%
Section 8 Moderate Rehabilitation	40,000 16.6%	24,981 11.3%	10,720 4.9%	0 0.0%
Public Housing	38,172 15.9%	36,370 16.5%	310 0.1%	0 0.0%
Total, All Programs	240,392 100.0%	220,501 100.0%	219,917 100.0%	121,615 100.0%

The 1983 Housing assistance programs rely heavily on a modified form of the Section 8 Existing program, sometimes called the "voucher" program. Note that in 1980 only about a fifth of newly assisted units were provided through the the use of existing housing, while over 90% of newly assisted units proposed in the FY83 program would be provided with existing housing.

[1] This column incorporates changes in the FY 1982 budget proposed in the FY 83 budget.

[2] While these units are classified as "newly assisted," in fact 60,615 of the units would be used to buy out obligations under the current certificate program, and the remaining units will be used in conjunction with the Rental Rehabilitation Progam and with the sale of HUD owned properites.

The assistance payments would not go up with higher rents or down with lower rents. If an assistance recipient chose to rent very expensive housing, the additional costs would come out of his/her pocket. Conversly, finding housing cheaper than the Standard Rent would accrue benifit to the recipient.

In addition, HUD is proposing elimination of inflation adjustments. Vouchers would be good for five years at the assistance level determined in the first year of participation. Under the current program assistance payments are adjusted each year to reflect changing rent levels.

The following table compares major aspects of the current and proposed programs and shows the Seattle area 1981 Fair Market Rents, estimated Standard Rents and income eligibility levels. For comparative purposes the Standard Rents have been estimated as if they had been implemented in 1981. The actual Standard Rents, when they are finally implemented by HUD, will also be adjusted upward to account for inflation.

Proposed Modifications: Section 8 Existing Program

	Current System- Section 8 Existing Program	Proposed System- Modified Section 8 Existing or "Vouchers"
Eligibility	Families, elderly, and handicapped below the 80% of median income standard (lidded in Seattle at 69.7%). Standards for the Seattle area are: 1 person $1271/month 2 persons $1450 3 persons $1629 4 persons $1813 5 persons $1925	Families, elderly, and handicapped below the 50% of median income standard, including food stamps. The 1981 standards for the Seattle area would be: 1 person $ 908/month 2 persons $1042 3 persons $1171 4 persons $1300 5 persons $1404
Household contribution	25% of adjusted gross income (i.e., after deductions of excess medical expenses and of $300 per child). The 25% includes an approved allowance for utilities. Congress has already approved the increase to 30%.	30% of adjusted gross income for new participants. The 5% increase will be phased in over the next 5 years for current recipients, i.e., 26% the first year, 27% the second, and so on. Again, income will now include food stamps.
Rental Assistance level	HUD pays the difference between the required household contribution and the total of the housing unit contract rent and a utilities allowance. This total cannot exceed the Fair Market Rent.	HUD pays the difference between the household contribution and a new "Standard Rent" for the size unit the household qualifies for. The assistance payment will be this difference regardless of the actual total expenses for the unit

SECTION 8 EXISTING HOUSING: PROPOSED CHANGES

The new program, explained in detail below, represents a number of shifts in the way HUD provides assisted housing:

> HUD will provide most housing assistance through existing housing units, relying on the private housing market, partially in response to the demand created by the HUD programs themselves, to provide new and substantially rehabilitated housing.*
>
> Housing assistance recipients will now be allowed to live in any housing they choose regardless of the rent (so long as it is not substandard housing). Assistance payments will be based on a "standard rent" and will not vary with the actual rent tenants pay. This program change will provide participants a reason to seek out the least expensive housing.
>
> HUD will reduce the amount of assistance provided to each household. Recipient households now are required to pay 25% of their incomes for rent. This maximum contribution will soon be changed to 30% although current participants will be "phased in" over a 5 year period. The new program will also require that food stamps be counted as income and will eliminate HUD paying for utilities in cases where utilites bills exceed the maximum household contribution.
>
> The modified certificates will be good for only five years at the same assistance level as the original year of application. There will be no annual adjustments for inflationary increases in rent levels.

Current Program: Under the Section 8 Existing program, housing assistance recipients pay a maximum of 25% of their adjusted gross income (after deductions for children and excess medical expenses). The 25% maximum also includes an allowance for utilities. There are more generous provisions for very large, very low income households, but these cases represent a very small part of assisted households. Eligible households are those whose incomes are under a set of income limits set by HUD. The income limit for a family of four is 80% of the area median income; this limit is adjusted for different household sizes. (The actual limit in the Seattle-Everett area is 69.7% of median income because of "lidding" of the limit in higher income areas such as Seattle.)

Eligible housing units are "decent, safe, and sanitary" housing units, generally units in good condition which have both bathroom and kitchen facilities and meet other HUD size standards. Rent for the units must be less than Fair Market Rents for the area. Fair Market Rents are rents determined by HUD to be the median (50th percentile) rents for qualifying housing in the area, excluding new units.

Proposed Program: A number of major modifications to the Section 8 Existing program have been proposed for implementation in FY1983 or sooner. Income eligibility limits for the program would be reduced from the current 80% standards to 50% of the median income. HUD is proposing that a new set of "Standard Rents" be used for determining the level of assistance to a recipient household. The standard rent would be the 40th percentile area rent level for housing units of each size, excluding new units. All "decent, safe, and sanitary" housing units would be eligible, regardless of rent levels. Assistance payments would the difference between 30% of adjusted gross income and the standard rent.

*Evidence from the Experimental Housing Allowance Program indicates that the market does not respond this way.

	Current System- Section 8 Existing Program	Proposed System- Modified Section 8 Existing or "Vouchers"
Rent levels	Fair Market Rents: These rent levels are 50th percentile rents for rental units in the region. The total of contract rents and utilities in assisted units cannot exceed these levels. Seattle-Everett area Fair Market Rents for 1981 are: 0 bedroom $274 1 bedrooms $334 2 bedrooms $394 3 bedrooms $493 4 bedrooms $539	Standard Rents: These rents are the 40th percentile of rents for units in the region. (Again, the rents include utilites costs.) Their purpose is only to determine the level of assistance for each certificate. Estimated Standard Rents for the Seattle-Everett area for 1981 are: 0 bedroom $248 1 bedrooms $303 2 bedrooms $357 3 bedrooms $447 4 bedrooms $488
Eligible housing units	"Decent, safe and sanitary" housing units with rents at or below Fair Market Rents. HUD Area Offices may exceed FMR's by up to 20% in certain circumstances.	Any "decent, safe and sanitary" housing unit. Participants may rent any price unit they wish, but additional rent above the standard rent will be paid by the tenant. Conversly, rent savings realized by renting a unit below the standard will accrue to the tenant.
Inflation adjustments	Certificates are updated annually using new participant incomes, contract rents, and Fair Market Rents	Certificates would be good for 5 years with no increase in the assistance payment. (Periodic inflation adjustments in the standard rents would apply to new participants only.)

LOCAL IMPACTS

There are a total of 9379 households in Seattle receiving direct rental assistance under various HUD programs. Of these, 1957 hold certificates under the Section 8 Existing program administered by the Seattle Housing Authority. The estimated "universe" of HUD Section 8 units* in Seattle is as follows:

	Elderly/ Handicapped	Families	All Sec 8 Assistance
SHA owned public housing	3959	1891	5850
Section 8 Existing (privately owned	881	1076	1957
Other Section 8	1426	146	1572
Total	6266	3113	9379

*Does not include 2078 units with direct rental assistance payments under the Rent Supplement Program. Most of these units are for elderly and handicapped persons.

It is the impact on the 1957 households in the Section 8 Existing program with which we are concerned. The following table shows the estimated income distribution among the households in this group.

Estimated Income Levels, Current Certificate Holders

Income level expressed as a % of median income	Elderly/ Handicapped		Families		Total, All Households	
	number	%	number	%	number	%
0% to 20%	479	54.4%	631	58.7%	1110	56.7%
20% to 30%	249	28.3%	196	18.2%	445	22.7%
30% to 40%	80	9.1%	107	9.9%	187	9.6%
40% to 50%	63	7.1%	107	9.9%	170	8.7%
50% to 80%	10	1.1%	35	3.3%	45	2.3%
All income groups	881	100.0%	1076	100.0%	1957	100.0%

Note: Estimates based on 10% sample of current certificate holders.

It is HUD's intent eventually to replace the current Section 8 Existing certificates with the new modified certificates. The following are assessments of the major changes in the program: the increased percentage of income that HUD is requiring participant households to pay (proposed for "phase in" over the next five years for current participants); the change in income eligibility from the 80% of median income based standard to a 50% based standard; the inclusion of food stamps for the purpose of determining the level of benefits; the elimination of a utilities allowance; and the implimentation of "standard rents" (replacing Fair Market Rents). The total impact of the changes is also assesed and summarized in a table on the last page. No attempt has been made to assess the long term impact of the elimination of an annual inflation adjustment.

Increased household contribution: The household contribution in Section 8 programs has historically been 25% of adjusted household income. As part of the FY 1982 budget, the tenant contribution was shifted to 30% of adjusted income. Regulations have not yet been issued to implement this change, but it is HUD's intent to phase in the new participation rate for current certificate holders, probably increasing the requirement by one percentage point per year. The total impact, i.e., making the change in one year, would increase the amount the average Seattle participant would pay by $23 per month; the first year impact would be an increase of a little less than $5 per month. (See summary table below for impacts on elderly, handicapped, and families.)

Income eligibility changes: Reduction of the income eligibility from the current standard to the 50% of median income standard will have little impact on Seattle certificate holders. Only about 2% of current Seattle certificate holders have incomes higher than the very low-income standard. The change would thus make about 45 households ineligible for assistance under the new system. Over three quarters of the households eliminated are non-elderly families.

Food stamps as income: The more serious impact on Seattle certificate holders is the proposed inclusion of food stamps as income. While no data on food stamp program participation was available in the sample, virtually all certificate holders are eligible. The average household coupon value for Public Assistance recipients is $105.46. Since housing assistance recipients are required to pay 30% of their incomes for rent, on the average, certificate holders will pay about $27 per month more in rent the first year of the "phase in", and eventually would pay about $32 per month more.

Standard Rent Implementation: Under the current program, recipients pay the difference between the required household contribution and the total of the contract rent and utilities allowance. This total is limited by Fair Market Rents. Under the proposed program, the assistance payment is the difference between the required household contribution and a new "standard rent", regardless of the level of the actual contract rent. Standard rents are to be defined as the 40th percentile of the same set of rental units and will thus be slighly lower rents for the same size units. In the Seattle-Everett area, 40th percentile rents are about 91% of 50th percentile rents.

Under the current system, the assistance level is the difference between the required household contribution and the total of the contract rent and the utilities allowance. The proposed program has an important provision: assistance recipients will receive the diffencenc between their required contribution and the standard rent for their unit size regardless of the level of actual rent or utilities costs. Thus, certificate holders whose actual rent and utilities are less than the new standard rent would gain from this change, and those who pay more would lose. Implementation of this change in 1981 would have resulted in an average loss in assistance of about $8 per month. Note that this change, in and of itself, would actually increase assistance to elderly and handicapped households while decreasing assistance to non-elderly households. (See table below.)

Total impacts: The table on the next page summarizes the losses and gains attributable to each program change. Note that the impacts of the changes in the household contribution requirement and in the income definition have been shown for one year only.

HUD has estimated that annual per unit costs of the Section 8 program will be reduced from about $3200 to about $2000. This appears to be inconsistant with the estimated impacts on Seattle recipients: Total savings per unit in Seattle appear to be only about $40 per month or about $480 per year per unit for the first year.

The long term impacts, of course, will be more severe. At the end of the 5-year "phase in" average assistance payments will have fallen another $22.62. Even this loss understates the real loss since program recipients will undoubtedly be paying much higher rents. Inflation in rent levels could increase average rents in the program by $100 to $200 per month per unit.

The analysis of impacts of the proposed program modifications is based on Standard Rent estimates for FY 1981. The estimates were made using 1981 Fair Market Rents (FMR's) and preliminary HUD estimates of the ratio between 50th and 40th percentile rents in the Seattle-Everett SMSA. Again, the Standard Rent estimates were made for 1981 in order to calculate the estimated impacts using 1981 program recipient data (incomes, contract rents, assistance payments, etc). The Standard Rent estimates are not predictions of those HUD will promulgate for the actual program. HUD will include an inflation factor in calculating the new rent schedule.

Summary of Estimated Impacts On Monthly Assistance
Payments to Section 8 Existing Certificate Holders

	Elderly	Handicapped	Families	All Hslds
Average Assistance Payment, 1981	$173.78	$209.30	$294.32	$245.73
Changes in Program:				
o Change from 25% to 26% of income (1st year of "phase in")	-$4.20	-$3.60	-$5.10	-$4.60
o Change from Fair Market Rents to "standard rents"	+$14.55	+$8.10	-$24.47	-$7.96
o Requiring food stamps to be counted as income (1st year impact)	(Information not available for each household type)			-$27.40
Total Impact, 1st Year Only	?	?	?	-$39.96
Estimated 1981 Assistance Payment Under Revised Program				$205.77

SECTION 8 NEIGHBORHOOD STRATEGY AREAS:

Progress in Meeting Goals

An Assessment of Unmet Needs

for

Substantial Rehabilitation

During January and February, 1982, the U.S. Conference of Mayors undertook a survey of all communities participating in the Section 8 Neighborhood Strategy Area (NSA) program. The purpose of the survey was to assess communities' progress in meeting stated goals in the program, and to assess needs for Section 8 substantial rehabilitation subsidy assistance to complete projects undertaken in earlier years after receiving HUD commitments to provide Section 8 funds sufficient to complete the approved projects.

The Section 8 NSA program is a five-year demonstration effort, currently entering its fourth year. The program was designed to provide local governments with special procedures for securing and processing proposals for Section 8 Substantial Rehabilitation assistance in conjunction with concentrated community development activities to revitalize target areas. The Section 8 NSA program placed full responsibility for soliciting, preparing, and completing initial processing on Section 8 assistance applications in the hands of local government for the first time.

Participants in the Section 8 NSA program were chosen after a national competition. Awards were made on the basis of comprehensive applications submitted by local governments in response to a federal invitation to seek designation.

Survey forms were sent to 100 communities participating in the Section 8 NSA program. A total of 93 survey forms were returned. One of the communities which responded to the survey has chosen to withdraw from the program, and thus is not included in the totals calculated in this report. The following sections summarize the findings of the survey; a copy of the original survey questionnaire is attached as Appendix I.

SUMMARY OF THE SURVEY RESULTS

Original Allocations

HUD originally scheduled a total of 34,000 Section 8 Substantial Rehabilitation unit reservations in the Section 8 NSA program after designation awards had been made. The total number of units accounted for in scheduled allocations to communities responding to the survey was 25,053, or about 74 percent of the total scheduled allocation.

Number of completed surveys	93
Number of total scheduled unit reservations	34,000
Number of total scheduled unit reservations represented by survey sample	25,053
Percent of total scheduled reservations represented by sample	74

Adjustments to Allocations

Communities were asked in the survey whether they were still working with the same number of units originally allocated to them in the Section 8 NSA designation. Forty-four of the communities said they were. Another 49 communities indicated some change had occurred, with a majority indicating they had scaled down their scheduled allocation of units during the course of the program.

Number of communities working with original allocation	44
Number of communities with adjusted allocations	49
Number of communities with increased allocations	(14)
Number of communities with reduced allocations	(35)

Progress in Using Section 8 Allocations

The communities responding to the survey indicated that a total of 7,019 units of Section 8 Substantial Rehabilitation housing have been completed and occupied through the NSA program to this date, or 28 percent of the total allocations represented. Another 682 units have been completed and are awaiting occupancy. A total of 3,119 units are presently under construction.

Eleven communities in the survey have completely finished their NSA effort, while a total of 10 communities are approaching the completion of their scheduled program. Five communities are half completed and 48 others said they have completed less than half their scheduled program. A total of 18 communities have yet to begin any construction in the program at this time.

Communities who have fully completed NSA	11
Communities approaching completion	10
Communities at the half-way mark	5
Communities with less than half completed	48
Communities which have not begun any construction	18

Number of Section 8 units completed to date	7,701
Number of Section 8 units completed and occupied	(7,019)
Number of Section 8 units completed & awaiting occupancy	(682)
Number of Section 8 units under construction	3,117

Future Reservations Needed to Complete NSA Programs

During FY82, 46 communities expected to bring an additional 4,249 Section 8 Substantial Rehabilitation units under reservation through the NSA program. In FY83, 18 communities expected to bring 1,324 units under reservation. Fifty-five communities reported they expected to be able to complete these obligations, provided subsidy funds continued to be available from the federal government. A total of 19 communities indicated that financing problems brought about by current high interest rates might jeopardize their ability to complete their programs. An additional 19 communities either didn't answer this question in the survey or marked it "not applicable."

	FY82	FY83
Units expected to be brought under reservation	4,249	1,324
Number of communities expecting further reservations	46	18
Number of communities expecting to complete obligations	55	
Number of communities who feel financing problems may jeopardize completion	19	
Number of communities not responding	19	

Further, a majority of the communities surveyed indicated that they could use a greater number of Section 8 units than originally allocated to completely meet all the needs in their target areas. The total number of units cited by those who gave precise estimates of the unmet needs added up to 13,982 units.

Communities also were asked to indicate the most pressing needs they faced in completing their Section 8 NSA obligations, and the overwhelming majority indicated that affordable financing for their units was the most pressing need.

Rating the Section 8 Program

Among the surveyed communities, 56 gave the Section 8 NSA program a very high rating, while 22 communities rated it a moderate success and 13 communities gave it low ratings. There was a high correlation between ability to complete scheduled Section 8 unit reservations and high ratings for the program. Among those who cited difficulties in the program and gave it a lower rating, high interest rates, unpredictable financing, strict HUD-FAA regulations and lengthy HUD processing delays were cited most often as the causes of frustration at the local level.

Mayor Latimer. Therefore, we think the early evidence we have on the use of section 108 has been very effective.

As to 312, the President's recommendation is to also withdraw from that program. That program has been very cost effective nationwide. In the city of St. Paul, for example, we have created 720 rehabilitated units, using a total of $8.9 million, and I do not think that we have a single default or a delinquency in that entire experience. We have had very good experience with the program. It goes to that whole notion of home ownership and the sense of identity and pride and commitment that people have, and I think it has the private sector involved, rather than purely a grant program would.

We think that the remaining ability to keep the revolving fund working in 312 should continue. The multiunit 312 use in St. Paul, which came later in the program, was very good, because we required that we first use abandoned or vacant units to use the 312 money for multiunits. As a result, we did not have displacement. We did have a big incentive, and we created some 176 new rental housing units that were all abandoned or vacant before.

So, those are almost like found housing units in a sense. They were abandoned for many years before we used them.

As to the position on the urban development action grant, I think this committee has already taken a position that the Conference and the League of Cities greatly supports. We think the Secretary's own evaluation and this Congress review of the program demonstrates your wisdom in creating it and supporting it. We support it at that level of $500 million and oppose the cut to $440 million proposed by the administration.

A few remarks on the housing level before I close, Mr. Chairman. You have already had ample discussion on the food stamp issue. I think I would like to highlight again the unwisdom of moving back from the Federal operating support. I think it is a most cost-ineffective kind of a saving. Forget about any claim for humanity.

The city of St. Paul has 4,400 units. Our vacancy rate in public housing is 2 percent. I have already told you that the average income is under 50 percent of the median, and that speaks for itself. We have already undertaken and gained savings of about 25-percent reduction in actual Btu consumption in those housing units. Any cutback that is projected based on the theory that those savings have not yet—are in fact going to be achieved in the future and therefore can absorb the loss is simply not based on the evidence.

We have already conserved. We have already cut back. We have a $3 million budget in the city of St. Paul housing authority. The administration already has taken a $1 million cut out of that $3 million. Because it is well-run, we will use the reserves for the rest of this year. They are now recommending an additional third cut of what little remains to operate and maintain the public housing.

I predict the Congress is going to act wisely in this matter. We have a nonpartisan, professionally managed public housing, and that administrator with 25 years experience has alerted me and the people of St. Paul that we have to start selling off the public housing when that reserve is used. That is a terrible prospect in a city that has already got people waiting in line for public housing.

I do not think that with a vacancy rate of 2 percent citywide that we can realistically look to the voucher system or any other kind of system as a way of easing that kind of hardship that will occur. I would urge you to restore the public maintenance cutbacks.

The reasons given by the Secretary as to expected savings and regulation, I have not seen one yet. I have never seen a dollar yet saved in that program by deregulation.

I have already commented on the energy savings that we have already had to undertake, and we should have and we did. And there is simply no base on which the administration can justify that kind of a cutback on housing.

As to the comments on the modernization money that the administration is talking about, that really offers a cruel choice to a local community, as you know. It simply takes one-half of the money coming from withdrawn public housing construction starts already undertaken and committed to by local communities. So, it is no real enhancement at all. It just deprives those housing units that are already committed without any hope that it will fill the void.

I know you will be having questions, Mr. Chairman. I have used up my time and a bit more. I thank you very much for your patience.

Senator LUGAR. Thank you, Mayor Latimer. Mr. Ritchie?

STATEMENT OF JOHN RITCHIE, EXECUTIVE DIRECTOR, VIRGINIA HOUSING DEVELOPMENT AUTHORITY

Mr. RITCHIE. Mr. Chairman and members of the committee. Thank you very much for the opportunity to testify today. My name is John Ritchie, and I am executive director of the Virginia Housing Development Authority. I also serve on the board of the Council of State Housing Agencies which represents some 52 State-authorized agencies in 46 States, the city of New York, Washington, D.C., and the Commonwealth of Puerto Rico.

I will ask that my written comments be published as part of the record, and I will summarize my comments here today.

Senator LUGAR. So ordered.

[The complete statement follows:]

COUNCIL OF STATE HOUSING AGENCIES

Prepared Statement of
John Ritchie, Jr.
Executive Director, Virginia Housing Development Authority
For the
Council of State Housing Agencies
Before the
U. S. Senate
Subcommittee on Housing and Urban Affairs

April 15, 1982

Mr. Chairman and members of the Housing and Urban Affairs Subcommittee, thank you very much for the opportunity to testify today. My name is John Ritchie and I am Executive Director of the Virginia Housing Development Authority. I also serve on the Board of Directors of the Council of State Housing Agencies. The Council of State Housing Agencies represents the 52 state-authorized housing finance agencies in 46 states, the City of New York, Washington, D.C., and the Commonwealth of Puerto Rico. Included in our membership are participants in the state housing finance industry including investment bankers, builders, developers and non-profit organizations.

Overview of Key Issues

The Housing Slump Is In Its Third Year

The downturn in housing production which began in the late summer of 1979 has grown worse over the passing months. With housing production at post-war lows and over one million construction industry workers unemployed, there can be no doubt that we have a depression in the housing industry. A shutdown of the housing industry has widespread impact on the economy. Revenues from property tax, home sales and related retail sales taxes, income and corporate tax and other fees associated with the sale of new and existing homes have fallen substantially. In place of these revenues to local, state and federal government we have rising unemployment, welfare claims and builder bankruptcies. Many sectors of the U.S. economy are suffering during the present rescession. None have borne the burden of high interest rates more heavily than the construction industry.

Conservative estimates of household formation, losses to the existing stock and necessary vacancy allowances indicate that we will need about 2.45 million new housing units per year during the decade of the eighties to maintain present levels of housing quality and availability.1/ If present trends persist, we are unlikely to have annual production this year that is much higher than last year's dismal level of 1.08 million starts.

The implications of this production shortfall are clear. Across income levels, renters and first-time home buyers will face a rapidly falling standard of living as prices for housing units will be bid up — where units are available. Most people who presently own homes will be in good shape if they aren't required to move and if their housing needs don't change.

The housing prospects for households at the lower end of the income scale are becoming grim. Rental shortages are forcing middle income households to compete directly with lower income renters for units. The vacancy rates for units affordable to moderate and low income households are significantly below the national vacancy rate for all rental units. Although public housing and Section 8 projects provide decent and affordable housing for millions of low income households, waiting lists for these units are long. For example, 40,000 Baltimore families are waiting for a vacancy in one of the city's 18,000 public housing units. New applicants for Dade County, Florida low income units face a 20-year wait.[2]

A Housing Policy Perspective

The many problems facing the housing industry require that Congress take action on a number of fronts. Traditionally, the Administration's housing bill has been the focus for discussion of comprehensive strategies to address the nation's housing needs. This year many issues, such as the need for low income rental housing production and the need for a construction industry stimulus, are not addressed or receive very inadequate treatment in the bill. In the following sections, I will outline the key aspects of a comprehensive response to the nation's housing needs and provide some comments on the Administration's proposal (S. 2361).

Preserve the Existing Low Income Rental Housing Stock. Presently, the nation is losing far more conventional rental units to demolition, abandonment and condominium conversion than are being built. Increasing energy and maintenance costs for the government-assisted housing stock seriously jeopardize the continued viability of these units. Rent increases for these low income units will not be sufficient to offset these operating cost increases. For both conventional and government-assisted units, the cost of replacing these units will be prohibitive. Congress must take the necessary steps to ensure that existing government-assisted housing, the only affordable housing option for millions of low income households, will be adequately maintained.

To preserve the existing stock of government-assisted low-income housing, Congress must continue to ensure that the annual adjustment factors used by HUD to determine Fair Market Rents (FMRs) on government-assisted housing appropriately reflect the true operating cost increases faced by these projects. Similarly, cost amendments to rental assistance contracts must appropriately parallel these FMR increases to keep government-assisted units affordable for low income households. Although default rates on HFA-financed rental housing have been shown to be among the lowest for government-assisted housing, CSHA supports the continued funding of the flexible subsidies program to assist both insured and non-insured projects as an efficient means to place marginal projects back on a stable financial base.

Build the Units Congress Already Has Budgeted and Appropriated. Presently, there are as many as 100,000 units in the production pipeline. These are units that have been appropriated by Congress but have not been built because of high interest rates. State HFAs alone have as many as 34,000 Section 8 units in the pipeline. The appropriated units in the pipeline constitute a full year's low income housing production. Financing out the pipeline not only will provide much-needed low-cost rental units but will also provide the most immediate "shot in the arm" for the residential construction industry with little or no additional budgetary impact. To get the pipeline going, Congress must raise the financing adjustment (FA) for bond-financed projects to reflect market interest rates and the construction start deadline for FA eligibility must be extended from June 1st. Finally, non-FA amendments must not be arbitrarily capped. Without additional higher amendment authorization, many projects won't be workable even under a FA.

which recognizes market rates. We are very concerned that the Administration has not addressed this key issue in its proposal. We are hopeful that Secretary Pierce will announce his recommendations regarding FA very shortly.

To Keep Bond-Financed Rental Production a Possibility, Congress Must Reject the Administration's Industrial Development Bond Proposal Which Would Prohibit Accelerated Depreciation of Bond-Financed Rental Units. Because of this provision and additional restrictions proposed by the Administration, rental housing bonds will be effectively terminated. Congress, following extensive study and debate, passed the Mortgage Subsidy Bond Tax Act. Sixteen months later, the Administration is proposing additional restrictions on rental housing bonds. These restrictions must be rejected (see attachment #1).

Congress Must Make Workable the $10 To $15 Billion Annual Single Family Mortgage Bond Program They Authorized In 1980. Because of unworkable restrictions in the Mortgage Subsidy Bond Tax Act, less than $2 billion in single family bonds were sold under the provisions of the Act last year. Congress should pass H.R. 4717, a bill that should go to conference any day now, which includes amendments to the Mortgage Subsidy Bond Tax Act. However, for housing bonds to be self-supporting, it is critical that allowable yield for revenue bonds be raised to 1.25%. With this arbitrage level, we anticipate that $10 billion in housing bonds will be sold this year. This volume of housing bonds would directly finance 185,000 moderately priced homes at below-market rates. This volume of housing bonds would create 330,000 man-years of housing construction-related employment and generate $1.8 billion in local, state and federal taxes. Housing bonds are not a panacea for the housing industry, but there is no question that a workable bond program could be quickly implemented. The costs to the Federal government have already been accounted for (see attachment #2). While Congress evaluates the numerous housing industry stimulus proposals that have been introduced, such as that introduced by Senator Lugar, a workable mortgage bond program could provide immediate interim relief for the construction industry by providing affordable financing to tens of thousands of first-time homebuyers.

Seek new options and partnerships in the production of much-needed low and moderate income housing. The Administration's bill, S. 2361, attempts to address the problem of housing availability in their rental rehab proposal. The Council believes that the program does not adequately address the need for preservation and rehabilitation of the rental stock and would prefer Senator Dodd's approach (S. 2171) with some minor modifications. (See attachment #3 for a critique of the Administration's proposal.)

The reliance on state and local administration in S. 2171 and the flexibility of the program are definite improvements over past federal rental housing production programs. In addition, the recognition of the value of mixed-income projects is an important aspect of this program. We would, however, suggest elimination of the priority for projects with the greatest amount of low income units since this is a housing supply program rather than an income transfer program. CSHA further recommends that funding not be done on a project-by-project basis. A federal fair share approach would ensure the allocation of funds to rural and other underserved areas. Effective support programs, such as co-insurance would add to the workability of the program. It must be made clear that the program is compatible with tax exempt financing to ensure that state and local government will be able to leverage limited federal dollars. With the modifications noted above, Senator Dodd's proposed production program could efficiently stimulate the production of low and moderate income rental housing and be adaptable to the special needs of rural households, the elderly and handicapped individuals. I would like to elaborate on these points.

Detailed Analysis

Preservation of the Existing Low and Moderate Income Housing Stock

Over the period of the last twenty years, the Federal government has provided housing for millions of Americans, many of whom to this day remain in government assisted housing. Young couples, large families, the elderly and handicapped of all races and pursuasions are assisted through government housing. The Federal Government must not abandon millions of people sheltered in government assisted housing. Adequate solutions must be arrrived at which reflect both a cost effective yet compassionate approach to support government assisted housing so that it can remain available to those who need it. The issues encountered today with respect to government assisted housing can be understood in a broad sense in terms of:

- operating costs which have risen over time and programs which do not accurately reflect the cost increases; and
- stagnant tenant incomes which can not support necessary rent increases.

CSHA opposes the "sunset" of the Section 236 program as of September 30, 1982. While we do not recommend further funding under this program, funds previously authorized may become available for various reasons after the proposed sunset date. These funds are currently an off-budget source of funds to assist State-aided developments. We would hope that the proposed sunset of the 236 program would not affect the potential use of these funds.

In addition, the Administration's proposal is conspicuously silent on the issue of future funding of deep subsidies under the 236 program. Absent continued funding under the rent supplement and rental assistance payments program (RAP) many low income families will be displaced from their homes. We are also seriously troubled by a management process which has not funded the amendments needed for 1981. We object to a process which is replacing rent supplement in FHA projects with Section 8 but which has thus far ignored state non-insured projects.

Both insured and non-insured developments have been receiving assistance under Section 201 of the Housing and Community Development Amendments of 1978. The "Troubled Projects Program" sometimes referred to as "flexible subsidy," has successfully corrected physical deterioration, replenished reserve accounts, and saved projects on the brink of default. This program is funded from the amounts repaid from funds collected in excess of the basic Section 236 rents. Despite the continuing obligation of non-insured projects to collect and remit this "surcharge" income, the Administration now proposes that these same state agency non-insured developments be excluded from any continued participation. This is not equitable. States are not only asked to correct their own problems, they must continue to contribute to a fund in which they cannot participate. CSHA also urges review of the administrative requirements of the flexible subsidy program which focus far too much attention on the ebb and flow of paper rather than on corrective action.

With respect to Section 236 projects, HUD regulations currently prohibit the combination of Section 8, Section 236 rent supplement or RAP to be applied to more than 40% of the total number of units in 236 projects. While this limitation may be waived by HUD, CSHA believes that this limitation should be completely eliminated so that residents of 236 projects in need of assistance may be eligible for the modified Section 8

Existing Program contained in the Administration's proposal.

In short, funding must continue to be equitably provided to support both state agency insured and non-insured projects. Limited funding for the rent supplement and RAP amendments through 1984 and the proposed curtailment of funding under the flexible subsidies program for state assisted projects will place state agency projects at risk - threatening the continued occupancy of such units by low and moderate income persons.

Modified Section 8 Existing Program

Sixteen state housing finance agencies and a number of state community development agencies currently administer the Section 8 Existing program and believe it to be a highly successful program. The Council strongly believes that "if it is not broke, don't fix it." The Administration's modified program provides no additional money - funding is to come from recaptured authority. Thus, virtually no additional tenants will be served. Additionally, the proposed program would require much clarification in order to be functional. For example, there are implied quality standards but no reference is made as to whether or not new criteria would be established or if the current Section 8 Existing standards will be maintained. A payment standard "based on the rental cost in particular areas of modestly priced standard housing of various sizes and types" is discussed in the modified program. The standard sounds very similar to the current Fair Market Rent System, but, no reference is made as to how the standard will be calculated, rather, it is left to the Secretary's discretion. An attachment to the testimony details CSHA's critique of the Modified Section 8 Existing Program (Attachment #4).

Funding the Pipeline

Estimates of the total number of units which could be provided for low and moderate income occupancy, which are today lodged in both the HUD and the state agency Section 8 pipeline, are placed at well over 100,000 units. Immediate action can be taken by the Congress and the Administration to alleviate the pressing demand for new rental housing, action which would create thousands of new job opportunities in today's all but crippled housing industry.

The Congress and the Administration are to be congratulated for their actions last fall establishing a Financing Adjustment (FA). The FA was designed to enable projects to be processed taking into account unusually high interest rates. Section 8 Fair Market Rents are adjusted in accordance with the terms of the permanent financing with a maximum of 12%. However, even with the FA, projects continue to be infeasible. Presently at issue is the fact that the 12% interest rate ceiling mandated by the FA regulations does not accurately reflect current interest rates. In addition, the FA regulations mandate that construction on all FA projects must commence by June 1, 1982. Market conditions simply will not allow for this schedule to be held. Congress can take immediate steps to make the FA workable by:

- permitting the 12% interest rate ceiling currently mandated by the FA regulations to be raised to more accurately reflect current interest rates; and
- extending the date by which construction must commence on all FA jobs from the current June 1 start date.

CSHA urges Congress to re-evaluate the current recapture/reuse ceiling specifically applicable to the FA (now set at 1.4 billion dollars nationwide) to determine whether this cap on reuse of previously commited Section 8 authority would artificially inhibit the development of Section 8 pipeline projects.

HFAs face two other barriers to project financing. HUD has revised the manner in which state agency units are transferred, and for all projects HUD has changed non-financial amendment policies without a change in regulation. These changes may preclude financing the pipeline, however, they are very technical in nature. We know committee staff have been instructed to review the issues involved and we will work with them and with HUD to seek early resolutions so we can get on with building low income projects which will reemploy thousands of workers.

Developing New Production Alternatives

Losses to the existing rental housing stock, the lack of low and moderate cost housing construction and rental demand pressure created from households unable to afford ownership units, all set the stage for a low and moderate cost rental supply crisis in the eighties.

Since the middle seventies, the economics of rental housing production have made rental housing production nearly impossible without below market financing and governmental assistance. Despite the fact that half of the rental households in the country earn less than $10,000 per year, in 1980 only 6,100 unsubsidized rental units with rents below $200 per month were completed.

The Administration's bill, S. 2361, attempts to address the problem of housing availability in their rental rehab proposal. The Council believes that the program does not adequately address the need and would prefer Senator Dodd's approach in S. 2171. This is more consistent with the spirit of new federalism as it relies on state and local administration. The success of state finance agency housing programs in the 70's, and the success of local community development efforts, all point to the fact that non-federal program administration is effective. We particularly support the flexibility provided in the Dodd proposal as a definite improvement over past federal rental housing production programs. In these days of tight budgets, maximum opportunity to leverage funds is critical and the proposal will allow for this.

In addition, the recognition of the value of mixed income projects is an important aspect of the program and we would suggest elimination of the preference for projects with the greatest amount of low income housing since this program would likely be the only production program available, directing resources to low income shifts the focus of the program away from housing stock and more toward income transfer.

CSHA recommends that funding not be done on a project-by-project basis. A federal fair share approach would ensure the allocation of funds to rural and other undeserved areas. To promote the development and continuation of professional state and local housing staff we suggest setasides for states and large cities. Effective support programs, such as co-insurance would add to the workability of the program. It must be made clear that the program is compatible with tax exempt financing to ensure that state and local government will be able to leverage limited federal dollars. With the modifications noted above, the proposed Dodd program could efficiently stimulate the production of low and moderate income rental housing and be adaptable to the special housing needs of rural households, the elderly and the handicapped individuals.

Another production alternative which the Council favors is a housing block grant approach. An attachment to this testimony details CSHA's Housing Block Grant proposal (Attachment #5).

Finally, Title III of the Administration's proposal would remove restrictions which effectively limit the amount of mortgages and loans which may be insured on a co-insured basis by FHA. CSHA applauds the Administration's efforts in this regard. However, appropriate action must be taken to make the current state agency co-isurance program operable. In its current context most housing finance agencies find the current program unworkable.

Summary Recommendations to Congress

During a time when the housing industry has been decimated by high interest rates and the need for low and moderate cost ownership and rental housing has reached crisis proportions, the Administration's housing bill offers no interim relief for the housing industry and generally reduces the federal government's traditional role in the provision of decent and affordable housing to lower income persons. To efficient respond to the pressing housing needs of this nation, CSHA offers the following recommendations to Congress:

Preservation of the Existing Low and Moderate Income Assisted Housing Stock

- Congress must ensure that non insured state financed projects which require rent supplement and rental assistance payment (RAP) are provided a level of funding authority and a distribution policy which adequately recognizes needs existing outside of the HUD insured portfolio.
- The flexible subsidies program, an efficient means to restore troubled low income housing projects to a stable financial base, must be continued for both insured and non-insured projects.
- The Section 8 Existing Program, a proven means to promote the preservation and moderate rehabilitation of the existing stock, must be continued. Housing vouchers are not a substitute for this program.

Financing the Section 8 Pipeline

- The current FA interest rate ceiling of 12% should be raised to more accurately reflect current market interest rates.
- Extend the date by which construction must commence on all FA projects from the current June 1 start date.
- The current recapture/reuse ceiling specifically applied to the FA (now set at 1.4 billion) should be re-evaluated relative to the number of projects to be processed under the FA guidelines.
- Amendment policies recently imposed by HUD outside the normal regulatory process should be withdrawn. Effective cost containment measures already exist in the Section 8 regulation in addition to voluntary cost containment measures underway in most state agencies.

- The Administration's policy decisions regarding the transfer of Section 8 and other funds previously applied to state housing finance agencies should be withdrawn to enable state agencies to effectively finance the pipeline.

Pass Legislation to Make Housing Bonds a Workable Housing Industry Stimulus and Means for Providing Affordable Mortgage Capital

- Congress should act quickly to pass Senate amendments to H.R. 4717. These amendments include protections against reserve fund losses and amend the 20% low income requirement for multifamily projects to 80% of median income for 10 years. Arbitrage provisions should be increased to 1.25%.
- Congress should push the Administration to issue workable multifamily regulations, and to revise the present unworkable single family regulations.
- Congress should reject efforts by the Administration to increase restrictions on multifamily housing as a part of Industrial Development Bond legislation.
- Congress should pass legislation eliminating the 1984 sunset provision for single family bonds.

Develop Effective Low and Moderate Income Housing Production Programs By Adopting S. 2171 With the Following Modifications:

- Project approval should not be done on a project-by-project basis;
- Setaside for states and large urban areas;
- Eliminate priority for projects with greatest amount of low income units;
- Allocation of program funds should follow a federal fair share approach to ensure adequate funding for rural areas and meet the special housing needs of the elderly and handicapped.
- A clear role for the tax-exempt financing must be included in the program designs to maximize the leverage of state and local participants.

In addition, CSHA supports the expanded use of co-insurance and recommends that appropriate action must be taken by HUD to make the current state agency co-insurance program operable.

This concludes my prepared remarks. CSHA looks forward to working with the Chairman in every capacity on this critically important legislative package. I would be happy to answer questions at this time.

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[1] ICF Incorporated. Housing Needs In the 80's. Washington, D.C., February 1981.

[2] "Public Housing Agencies Face Cuts As Demand, Repair Costs Mount" Daily Bond Buyer. March 19, 1982 : 19.

ATTACHMENT #1

COUNCIL OF STATE HOUSING AGENCIES

Administration Proposed IDB Legislation Will End Low and Moderate Income Rental Housing Bonds

The Administration's proposed legislation to curb the sale of industrial development bonds not only applies to rental housing bonds used by state and local government to finance the production of critically-needed low and moderate income rental housing, if passed, the legislation will effectively end this program. The combination of these proposed restrictions with the restrictions already set in place under the Mortgage Subsidy Bond Tax Act of 1980 will make issuance of rental housing bonds a virtual impossibility. In a separate proposal, the Administration also will nearly eliminate the Section 8 and public housing production programs. The Administration IDB proposal will remove from the hands of state and local government their most effective means for shouldering the responsibility of moderate income rental housing production.

The economics of rental housing production, as demonstrated since the mid-seventies, have made moderate income rental housing production nearly impossible without below market financing and preferential tax treatment. Despite the fact that half of the renter households in this country earn less than $10,000 per year, in 1980 only 6,100 unsubsidized rental units with rents below $200 per month were completed. Last year in recognition of the need to stimulate rental housing production, the Congress passed legislation to improve the tax treatment of rental housing. Under the Administration IDB proposal, prohibiting the application of the Accelerated Cost Recovery System (ACRS) to bond-financed rental projects, will require that rents must rise as much as $200 per month to offset the loss of the tax benefit. With the present low income requirement for bond-financed rental housing, eliminating accelerated depreciation will make these projects economically infeasible or unaffordable by low income tenants. Either way, bond-financed rental housing won't be built.

Rental Housing Bonds Received Extensive Congressional Scrutiny and Targeting Restrictions In the Mortgage Subsidy Bond Tax Act of 1980.

Following two years of study and debate, Congress passed the Mortgage Subsidy Bond Tax Act of 1980. As an outcome of that law, all rental housing bonds issued since January 1, 1982 must be in registered form (a provision also included in the Administration proposal). The 1980 Act also stipulates that, in bond-financed rental projects, at least 20% of the units must be reserved for low income households (a more specific targeting provision than what is included in the Administration proposal).

In recognition of the critical public purpose played by multifamily bonds, Congress exempted them from the 1984 sunset that was applied to single family bonds. Moreover, because of the costs and risks associated with low and moderate income rental housing development, Congress exempted multifamily bonds from the strict arbitrage and reserve fund restrictions that were applied to single family issues.

The key point is that, sixteen months ago, Congress completed lengthy deliberations on housing bonds and produced legislation to ensure their targeted and efficient use. There have been major problems with the Mortgage Subsidy Bond Tax Act, not the least of which is the virtual preclusion of self-supporting single family bond sales. Rather than starting from scratch on an entirely new piece of housing bond legislation, CSHA strongly recommends that Congress make the needed "fine-tuning" adjustments to the 1980 Act and exclude rental housing bonds from the Administration proposal.

Rental Housing Bonds Are Not a Run-Away Program

There is a significant error in the Adminstration's explanation of its IDB proposal ("General and Technical Explanations of Tax Revisions and Improved Collection and Enforcement Proposals," Department of the Treasury, February 26, 1982). On page 25, the Administration charts the growth of "Housing" bonds between 1976 and 1981. Although the proposal does not apply to single family mortgage revenue bonds, single family bonds were included in the annual totals. Below, Table 1 accurately compares annual volume of rental housing bonds and small issue IDBs since 1976. Average annual growth of rental housing bonds over the last five years has been less than 11%. In fact, rental bond volume has been dropping steadily since 1979. These annual totals closely follow production levels under the Section 8 program. Fully one-third of all Section 8 units have been financed by state housing finance agencies with bonds. Combining state HFA and local bond financing via the 11-b program accounts for the vast majority of multifamily rental housing bond issues during the last six years. If the purpose of the Administration proposal is to curb runaway growth in IDB volume, such measures are unnecessary for rental housing bonds because market forces relating to rental housing development and cut backs in federal production assistance programs already serve that purpose.

The Nation Faces a Major Crisis In Rental Housing Supply

Eliminating federal supports for low and moderate income housing production and severely restricting state and local access to tax exempt rental housing bonds will cut national rental housing production in half and virtually eliminate all low and moderate income rental housing production.

The reason unsubsidized rental housing is not being built in any quantity is that households who can afford the rents required by new rental units more often than not can afford to buy a home. As a result, homeownership has "creamed off" the higher income renters and left a renter population unable to afford newly built units. Beside the fact that few non-luxury conventional apartments are being built, annual losses to the rental stock due to condominium conversion, abandonment and demolition are having a devastating effect on rental housing supply. George Sternlieb of Rutgers University

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Table 1

Small Issue IDB and Rental Housing Bond Growth 1976-1981*

	1981	1980	1979	1978	1977	1976
Small Issue IDBs	10.5	8.4	7.1	3.5	2.3	1.5
Rental Housing Bonds	3.7	4.1	5.6	3.7	2.3	2.4

*Statistics from Daily Bond Buyer and Congressional Budget Office estimates that demolition and abandonment losses to the existing rental stock will average 578,000 units annually during the eighties.

Estimates of increases in rental need resulting from household formation range from 290,000 to 400,000 units per year throughout the eighties. When losses to the existing stock are added to household-formation-related statistics we see—as a minimum—that an annual rental production requirement of 600,000 units per year is needed to maintain the current rental supply. Advance Mortgage Corporation reports that in 1981, conventional unsubsidized apartment starts were slightly over 100,000 units—at all price ranges. With the federal government backing out of low income rental housing production and if these proposals to strangle rental housing bonds are passed, how will the critical need for low and moderate income rental housing production be met?

The Administration Offers No Low and Moderate Income Rental Housing Production Alternative to Rental Housing Bond Programs

The Administration proposes to terminate all federal assistance for the production of new and substantially rehabilitated Section 8 housing and public housing. The total commitment of the federal government to low cost rental housing production is 10,000 units of Section 202 elderly housing under the Administration's 1983 proposal. The Administration also is seeking to cancel tens of thousands of Section 8 units that were appropriated in prior years and now are in the production pipeline.

The Administration offers a housing voucher program as its response to the plight of low income rental households across the country. The Experimental Housing Allowance Program demonstrated clearly that housing vouchers will do little to promote moderate rehabilitation of rental housing and nothing to promote new construction or substantial rehabilitation. Nothing. As the number of rental units declines due to abandonment, demolition and condominium conversion, housing vouchers will simply provide more dollars to chase after a steadily declining number of goods.

Because of the high cost of rental housing production, rental housing bonds alone cannot replace Section 8 and public housing as a direct response to the housing needs of low income renters. Rental housing bonds do offer state and local government a practical means to continue to produce moderate cost rental housing. Applying housing vouchers to bond-financed rental units will make workable the low income requirements for bond-financed projects. State housing finance agencies alone have financed 360,000 low and moderate income rental units with bonds. By restricting state and local access to rental housing bonds, the federal government will dismantle state and local low and moderate income housing delivery systems while, at the same time, they are dismantling HUD and FmHA low income rental housing production assistance capacity.

The Administration Proposal

The Administration proposal to restrict IDBs has four major provisions that will directly impact on rental housing bonds:

- All rental housing bond issues are to be subject to public review and approval by elected representatives of state or local government;
- After 1985, state or local government must provide for the rental development an in-kind contribution with a present value equal to 1% of the bond issue;

- Rental housing developments financed with tax exempt bonds cannot benefit from the depreciation provisions in the Accelerated Cost Recovery System implemented under the Economic Recovery Tax Act of 1981; and
- Agencies will not be allowed to earn arbitrage on the interim investment of bond proceeds or on the investment of reserve fund capital. Bond underwriter discounts and bond counsel fees cannot be applied to calculations for arbitrage limitation purposes.

All of these proposals significantly increase the degree of federal regulation over rental housing bond issues. The public review requirement will jeopardize the timing of bond sales and may allow small community factions to delay project construction due to objections over project siting. Presently, all state HFA bond issues are subject to review and approval by boards appointed by state governors and legislatures.

Requiring an in-kind contribution from state government may be workable in some cases. However, a provision of this kind clearly discriminates against less affluent states—the very same states that may be most in need of low and moderate income rental housing.

Excluding bond-financed rental housing from the accelerated depreciation provisions of the Economic Recovery Tax Act will effectively restrict low and moderate income rental housing investment to a small number of nonprofit corporations. Investor owners will not build low and moderate income rental housing because the opportunities for appreciation will, in most cases, not offset the costs and risks. Rental housing investment syndicates will be ruled out entirely. Many non-profit groups rely on the syndication process to raise capital for housing services, reserve funds and to lower rents. More than any other provision of the Administration proposal, the exclusion of bond-financed properties from accelerated depreciation will kill investment in low and moderate income rental housing.

The arbitrage and reserve fund sections of the proposal involve another attempt to weaken the security of low and moderate income rental projects. A similar proposal was rejected by Congress in the Mortgage Subsidy Bond Tax Act. If passed into law, these restrictions would eliminate the ability of issuing agencies to develop the cash reserves necessary to ensure the long-term viability of rental projects.

These measures, in tandem with the restrictions already implemented under the Mortgage Subsidy Bond Tax Act, will make it extremely difficult for state and local government to issue rental housing bonds. Where bond issues are workable, the prohibition regarding accelerated depreciation will preclude any private investment in low and moderate income rental housing.

Conclusion

Congress, following lengthy examination of the issue, recently passed comprehensive housing bond legislation in the Mortgage Subsidy Bond Tax Act. The shock waves that the 1980 Act sent through state and local government are still being felt. The Senate recently has passed legislation to remove a number of the most impractical aspects of the 1980 Act. Taking up new, and far more restrictive, housing bond legislation is premature and clearly unjustified given the great need for rental housing and the declining role of the federal government in low and moderate income rental housing production. The Council of State Housing Agencies strongly recommends that Congress strike all reference to rental housing bonds in this legislative proposal.

ATTACHMENT #2

COUNCIL OF STATE HOUSING AGENCIES

In Support of Mortgage Revenue Bonds

In 1980, Congress perceived a danger in unlimited mortgage revenue bond (MRB) programs and passed legislation to limit bond volume and target the use of bond proceeds. Unfortunately, technical provisions of the law, unrelated to the targeting and volume restrictions, have made MRB programs virtually unworkable. Despite regulatory action by the U.S. Treasury to relax some of the restrictions, 1981 MRB issues covered by the 1980 Act amounted to less than $2 billion: less than 15% of the Congressionally-imposed volume limit. The majority of these issues required a contribution from HFA reserves or state appropriations to cover issuance cost shortfalls resulting from restrictions on the use of bond proceeds.

The Need for Mortgage Revenue Bonds

- Despite unprecedented housing needs, single and multifamily housing production is at its lowest post-war level. Conservative projections of interest rate levels for 1982 suggest that the depression in housing, now in its third year, will continue.

- Unemployment in the housing and real estate industries now numbers over one million. The lack of affordable mortgage capital jeopardizes the viability of all sectors of the housing industry and sets the stage for large scale housing-related price inflation when the economy does recover.

- Losses to the existing rental housing stock, the lack of low and moderate cost rental housing construction, and rental demand pressure created from households unable to afford ownership units all set the stage for a low and moderate cost rental supply crisis in the eighties. Presently, we are losing more units than we build.

- Low income families need low cost energy and home improvement loans. Only tax exempt financing can provide these loans at reasonable interest rates. Otherwise the retail rates, which are well above mortgage rates, must be paid.

The Benefits of Mortgage Revenue Bonds

- To date, State HFAs have used mortgage revenue bonds to finance 418,000 single family and 360,000 apartment units. No two HFAs are alike in the way that they have tailored their programs to serve state housing needs.

- $1 billion in mortgage revenue bonds will provide direct below-market financing for 18,500 first-time homebuyers. The direct and induced sales effect of $1 billion in MRBs totals over 40,000 housing units.

- $1 billion in mortgage revenue bonds will stimulate the production of 15,000 new homes. This housing production will provide 33,000 man-years of construction-related employment.

- In the first year, $1 billion in revenue bonds will generate $126 million in federal personal and corporate income taxes and $54 million in state and local tax revenue. Annual real estate taxes alone on 15,000 new bond-financed units ($18.56 million) will nearly offset federal revenue expenditures associated with $1 billion in bonds. In sum, mortgage revenue bonds are a net generator of tax revenue for federal, state and local government.

- The social benefits of mortgage revenue bonds include making the dream of ownership a reality for thousands of renters. By freeing up rental units, pressure in the rental market is reduced. Bond capital is the only affordable source of home improvement and energy conservation retrofit capital for thousands of American households. Bond programs allow state and local government to take responsibility for housing and promotes the elimination of ineffective federal bureaucracies.

The Costs of Mortgage Revenue Bonds

- Estimates of the annual revenue expenditures of mortgage revenue bonds range widely. The Congressional Budget Office estimate, $22.5 million per $1 billion in bonds, falls in the mid-range of these estimates. This estimate, however, does not take into account the reduction in the maximum tax rate on unearned income from 70 to 50 percent.

- Arguments that MRB programs will deluge the municipal bond market and spur significant increases in bond yields are no longer valid given the housing bond volume limitations imposed by Congress.

- Presently, 75% of all tax expenditures for housing accrue to households earning more than $30,000 per year and claiming mortgage interest and property tax deductions ($30 billion per year according to CBO). CBO estimates that mortgage revenue bonds account for less than 5% of all housing-related tax expenditures.

- During a time when nominal declines in housing prices are being seen across the country, MRB programs are not likely to have an inflationary impact on housing prices. In fact, by preventing the collapse of the housing industry, bond programs can stave off widespread housing price inflation when the economy does recover.

During a time when Congress and the Administration are considering many new and largely untested options for aiding the housing industry, it is ironic that they have not recognized the facts that the MRB delivery system is in place, bond programs are efficient, thousands of first-time homebuyers could benefit and the housing industry could receive a much needed shot in the arm from MRB programs.

COUNCIL OF STATE HOUSING AGENCIES

Attachment #3

CSHA's Comments on the Administrations Rental Rehab Program

1. CSHA applauds HUD for acknowledging the need for housing rehabilitation. The proposed legislation defines this need as 1.8 million units that are seriously deficient and 2.6 million with significant inadequacies.

2. However, the program proposes to treat only 30,000 units. Obviously HUD's own definition indicates a need for a much greater production level. CSHA believes that a more suitable level of activity is provided in the Dodd/Gonzales proposals.

3. Additionally, this legislation offers no production vehicle to support new construction.

4. The program would dictate to cities and states:

   a. What neighborhoods to treat;

   b. How to structure the rehab development; and

   c. Acceptable rent levels for 80% of the initial after-rehabilitation rents for assisted properties. In fact, the proposal sets rent levels below the figure established by HUD as the applicable payment standard.

5. A better approach would be to provide a true housing block grant which could be used in ways which make sense in the housing market of any given state, city or town.

6. The claim that this program will be able to assist a significantly larger number of property owners and low-income tenants than current programs is unsubstantiated.

7. There is a need for greater flexibility in how a state allocates its share of the funds. Priority should go to non-entitlement areas, but there should be an opportunity for states to support special efforts being made in entitlement cities. There should also be the opportunity for cities and states to make special arrangements for states to administer the program in cities. Flexibility should also be maintained in the manner in which grant funds may be used by states and localities.

8. A $100,000 grant minimum is too small to support effective program administration in any municipality or urban county. By increasing the minimum grant level, HUD would assure that the areas with greatest needs are being served. Also, money could be aggregated at the state level to channel it to the areas with the greatest needs.

9. The legislation does not specify that funds raised through tax-exempt financing would qualify for the 50% required to match the grant. For HFAs to participate in the program, this must be made clear. If the Administration intends to come forward with a production program, it should not ignore the capabilities of established, proven production vehicles such as housing finance agencies.

10. This proposal runs counter to requirements imposed by the Mortgage Subsidy Bond Tax Act of 1980 (Ullman legislation). That law requires that for 20 years, 20% of the units in each development must be rented to low income tenants. The HUD proposal does not provide for subsidies to be tied to units rehabilitated with the proceeds of tax-exempt bonds. Without the assurance of long-term rental assistance to meet the 20% requirement, it will be difficult if not impossible for HFAs to finance the rehabilitation of rental projects. However, this whole issue may be rendered moot by the Administration's industrial development bond proposal which will effectively eliminate revenue bonds as a financing source for rental housing.

11. Taken as a whole, the program is restrictive in that it dictates the types of neighborhoods and types of buildings which can be treated (especially considering that the underwriting must "make sense even if buildings have no certificate holders renting units"). Clearly this proposal is designed to address no more than 30,000 units, even if it were extended beyond one year. This then is not a nationwide housing production program of any magnitude.

12. CSHA believes it preferable to tie the vouchers (certificates) to the rehabilitated buildings rather than to the tenant. In addition to serving low-income people this would provide:

    a. Incentives for landlords to participate in the program because a guaranteed source of income to pay back a loan;

    b. Incentives for a lender to take the risk of making such a loan;

    c. Effective targeting of properties and neighborhoods;

    d. An incentive for state agency participation. HFAs could assist in monitoring the program to help it succeed over time.

13. The prohibition against syndication:

    a. Hampers the operation of the program by precluding the parteipation of developers;

    b. Eliminates a source of additional funds to support needed rehabilitation; and

    c. Confirms the impression that HUD intends to keep the program very small, disproportionately so compared with the need.

COUNCIL OF STATE HOUSING AGENCIES

Attachment #4

Comments on the Modified Section 8 Existing Program

Payment Standard

Although we agree with the Department's decision to have the subsidy go directly to the landlord, we question the benefit of establishing a whole new payment standard when the Fair Market Rent system is already in place. The FMR system was designed precisely for the purpose of reflecting real housing costs for particular market areas. We believe the current system is working quite well and should be maintained. It is unnecessary to devise new formulas, new regulations and more bureaucratic red tape when a functional system is in existence.

Secondly, the modified program could result in substantial rent increases and could seriously affect tenants currently receiving assistance under the Section 8 Existing Program. For example, assume a tenant's five year contract is up for renewal and he/she would qualify for the modified Section 8 Existing program. The new payment standard under the modified program is substantially less than under the current Section 8 Existing program. Therefore, since it is unlikely that the landlord will lower the rent, the tenant, in order to remain in the unit, will be required to pay more than 30% of his/her income toward rent.

Shoppers Incentive

The Council has serious objections to allowing a tenant to rent below the standard and pocketing the savings. Aside from the fact that this concept was implemented and subsequently withdrawn during the Experimental Housing Allowance Program, we object based on the potential abuses that could occur. The "shoppers incentive" could encourage overcrowding and marginal unit choices. In poor markets where tenant choice of units is limited, the tenant is left at the mercy of the landlord. By the same token, tenant payments in excess of the standard could result in property owners collecting rents that are not reflective of market areas.

Housing Quality Standards

The modified program implies that there will be Housing Quality Standards but fails to reference what standards will be used or if they will include regional variation. The Council believes strongly that the current Section 8 Existing Quality Standards should be maintained. Continuing these minimum quality standards guarantee that the program meets its purpose of improving the living conditions of low income households.

Program Administration

The proposed modified Section 8 existing program may result in adminstrative nightmares. Allowing tenant mobility across state lines, which is a good concept, causes several administrative questions such as - who administers the program when a tenant moves from a state which participates in the program to another state which does not administer the program? Who is responsible for inspecting those units? Who certifies tenant eligibility given a new payment standard as a result of the move?

Unlike the current Section 8 existing program, the modified program neglects to mention a fee for administering agencies. Collection of these fees is necessary in order to offset agency staff and delivery costs.

Vacancy Payments

The proposed vacancy payment provision is unacceptable. The current Section 8 Existing provision governing vacancy loss is preferable. Currently, the owner can retain HAP monies paid for the month in which the family vacates and can collect up to 80% of the contract rent for a vacancy period not to exceed thirty days after the tenant leaves the unit. The Administration's bill, S. 2361, would only provide vacancy payments for the month during which the tenant leaves the unit. This might be feasible if the tenant left early in the month but if the tenant vacates at the end of the month the owner loses at least one month's rent.

Unlike the current Section 8 program which allows an owner to file a claim in case of property damages, the modified Section 8 existing program does not address this issue. This provision is necessary to encourage landlord participation. Likewise, the current policy set forth in the Section 8 Existing program which allows an owner to collect a security deposit of $50 or the monthly gross family contribution, whichever is greater, also needs to be incorporated in the modified program for the same reason as mentioned above.

Finally, regarding tenant landlord leases, we prefer the 12-month minimum lease as in the current Section 8 Existing program over the one-month minimum lease in the modified program. One month leases create tremendous administrative burdens.

ATTACHMENT #5

COUNCIL OF STATE HOUSING AGENCIES

I. CSHA POSITION ON HOUSING ASSISTANCE BLOCK GRANTS

This paper develops essential program components of housing assistance block grants from the perspective of state housing finance agencies. State housing finance agencies bring to the block grant arena long and varied experience in delivering subsidized housing to low and moderate income households.. Their unique record of achievement carries promise for optimal program delivery in the face of reduced federal subsidies and radical program change. To fulfill this promise, however, the block grant framework must give sufficient responsibilities and funds to states for developing feasible housing programs. This means that Housing Assistance Block Grants must include a housing production component that is administered by states. We are proposing that 30% of the total pool of block grant funds allocated within a state be reserved for statewide housing rehabilitation and new construction activities, if that state has established a housing finance agency.

State housing finance agencies have the technical capacity, beyond any other state or local entity, to leverage funds with outside sources and promote innovative financing mechanisms for reducing housing costs. Moreover, under the direction of state agencies, funds would be allocated to the areas of greatest need, whether they be large or small, urban, suburban or rural. In this way, the rigid guidance of federal directives would be replaced by the detailed knowledge and indigenous perspective that only state governments can offer.

CSHA's Concept Of A Housing Assistance Block Grant

Federal resources can address priority concerns most effectively when allocation decisions are made by state and local governments. No single form of housing assistance is appropriate for the nation as a whole. Housing needs differ from community to community, as well as by age group, tenure type, family size and income. Block grants can be responsive to this national diversity, producing programs tailored to local conditions. Federal new construction and substantial rehabilitation of rental units must augment the housing supply in many low income areas. Where vacancy rates have reached record lows, and condominium conversions and abandonments of dilapidated stock further diminish housing choice, the number of housing units must be increased to assure adequate housing for low income tenants. Housing allowances have not stimulated new construction or major rehabilitation activities. Housing block grants, which could be combined with housing vouchers, would allow municipalities to select the programs they need.

HFA Capabilities

Housing Assistance Block Grants should be designed to take advantage of the experience and proven delivery techniques offered by state housing finance agencies which are empowered by state legislatures to finance housing through the issuance of bonds and to participate in federal housing programs.

At the State level, HFAs offer the range of administative capabilities that most closely match those required under a housing assistance block grant. HFAs have played a major role in the delivery of Section 8 new construction, (substantial rehabilitation) and existing rental assistance. The 32 HFAs that are involved with the Section 8 new construction program have financed nearly 200,000 units, or about 28 percent of all units started. Many State agencies are now also administering Section 8 existing housing programs. The Georgia Housing Finance Agency for example currently administers a 5,000 unit Section 8 existing housing program. A number of HFAs such as Maryland and Virginia also administer Section 8 Mod Rehab Progams.

State agencies participate in other Federal housing programs including: FmHA Section 502 single family program, FmHA Section 502 and 504 rehabilitation programs, and construction financing for the FmHA Section 515 multifamily program which offers interest subsidies at below-market rates.

Beyond the delivery of Federal programs, State Housing Finance Agencies have developed a range of housing services to meet specific state housing needs. Examples of state HFA-sponsored programs include: Home Improvement loans, Mortgage Insurance, Seed Money Loans for Nonprofits, Energy Conservation Loans, Group Homes for the Elderly and Handicapped.

In its primary role as a provider of moderate and low cost ownership and rental housing, the accomplishments of State Housing Finance Agencies are particularly noteworthy. Despite the fact that most State HFAs are less than ten years old, these agencies have financed nearly 300,000 single family homes and almost 500,000 multifamily rental units.

In its feasiblity report on Housing Assistance Block Grants, HUD indentifies State HFAs as the major source of housing development and management expertise on the State level:

> "Through SHFAs, States have developed considerable capacity to plan, develop, and finance housing with staffs of trained specialists with skills in marketing, appraisal, architecture, management and related specialties. Partnerships have been established with both the private sector (through loan origination and servicing, mortgage purchase and loans to lenders) and the Federal government (through the use of subsidies and FHA and FmHA insured mortgages)".*

Experience with Federal housing assistance, extensive experience in housing development and management and established relationships with the private sector and local communities, make state housing finance agencies the logical candidates to administer Housing Assistance Block Grant programs.

State agencies are unique, inasmuch as they are neither a purely public agency nor part of the private sector. They are, rather, a link between the two, drawing upon the resources of the private mortgage lending industry and private developers while serving to help those families who cannot be served by private industry without some form of governmental assistance. Mindful of the public purpose of tax-exempt borrowing, most state statutes limit multifamily borrowers to public, non-profit, and limited dividend entities. These statutes also target low income areas or limit the income levels of single family borrowers and occupants of multifamily developments to people with low and moderate incomes.

* Office of Policy Development and Research, Housing Assistance Block Grant Report (Draft). U.S. Department of Housing and Urban Development, Washington, D.C, April 1981 (Chapter VIII, Page 16).

Not only are HFAs disciplined by the risk inherent in the housing development industry, most HFAs also answer to boards composed of responsible private and public officials, to private industry participants and concerned public interest groups, to state legislatures and governors, to public pressure, to the press, and to the bond market in which they raise money. Through state finance agencies,.tax exempt financing has become an important and efficient tool for stimulating low income housing production. This stimulus would continue under housing block grants and should be considered an integral part of the program's design.

New legislation will define the relationship of state agencies to HUD and to other state and local entities. To attain maximum program feasibility in the presence of many diverse and competing interests, state agencies must build upon past achievements in order to resolve the crucial issues of the future. A proposed position on these issues, with accompanying explanations of the reasoning and constraints, is given below.

Program Format

Concept: The Folding In of Existing Programs

All categorical housing programs, except funds in support of existing public housing and FHA-insured projects, should be folded into block grants for assistance to low and moderate-income home owners and renters. There should be a housing stock component that supports programs for housing maintenance and new construction, and income supplements for people who cannot afford adequate dwelling space. The housing stock component would be devoted to housing production needs.

CSHA Analysis and Position

Support for future federally-subsidized housing activities must be consolidated to provide needed flexibility and maximum program results, especially in the context of diminishing federal resources. Programs that should be terminated include public housing, Section 8 (including new construction, substantial and moderate rehabilitation and existing), Sections 312,202,235, Tandem subsidies, Farmers Home Administration programs and Sections 502, 504, and 515. Any recaptured budget authorities from project terminations should be folded into annual housing block grants for the areas where the recaptured funds originated. Operating and modernization subsidies for public housing projects and flexible subsidies for troubled projects should continue from separate federal funding sources.

Incorporating Farmers Home Administration programs is particularly important in states with small populations. With 80% of HUD's assisted housing funds directed to metropolitan areas, the amount of funds remaining for non-entitlement areas would not be adequate to carry out a range of housing activities in many states. The retention of Farmers Home Administration categorical programs would defeat the purposes of a housing block grant and merely shift current HUD/FmHA geographic and program duplication problems to states and local governments.

Concept: Fair Share Allocation by HUD

The entire pool of housing assistance funds should be apportioned among states by HUD, using a fair share formula that reflects nation-wide data on rural, urban and metropolitan area housing needs for new construction, housing preservation and housing vouchers. The formula should be adjusted by region to compensate for regional differences in shelter costs, particularly rent levels, construction and utility costs. Funds alloted to individual states would then be divided by HUD between entitlement and non-entitlement areas.

CSHA's Analysis and Position

Reasonable measures of housing need by states and the comparative needs among states can be calculated and updated most efficiently at the national level. U.S. Census and Annual Housing Survey data provide the necessary information for making equitable distributions to states and to entitlement and non-entitlement areas within states. These data sources eliminate the need to involve cumbersome and time consuming local participation in processing allocations. Regional cost differences should be factored into the distribution formula because the cost of producing housing and operating housing services varies substantially from one region to another.

Concept: Entitlement Areas

HUD would establish at least two funding categories for most states, one for entitlement cities and another for the rest of the state. Where a state has no entitlement cities, HUD would turn over the entire block of funds to states for state-wide distribution by states. Designated entitlement cities should receive their allocations directly, and administer the funds according to local determinations of housing need. In states where there are no entitlement cities and in areas of states outside of entitlement cities, states should administer the allotted funds. Urban counties and regions should not be considered entitlement areas.

CSHA's Analysis and Position

States, rather than regional agencies, should administer block grants in metropolitan and rural areas outside of entitlement cities. The larger jurisdiction will permit the concentration of funds in areas with the greatest need, and accommodating natural housing market boundaries rather than the artificial boundaries created by local governments.

Concept: A State Finance Agency Allocation

A third allocation category would be established in states that have created a state housing finance agency and wish to initiate innovative financing and specialized construction programs. These programs would operate throughout the state in entitlement and non-entitlement areas.

CSHA's Analysis and Position

The set aside for state housing finance agency programs will give states the flexibility they need for creating effective financing techniques to remedy localized single family and multifamily housing problems that have been identified throughout the state. It will maintain a strong institutional housing structure at the state level to help local governments reach their objectives when solutions to local problems strain local capacities. It will finance construction for special housing needs and purposes.

Concept: The Allocation Process

HUD's assignment of funds within states to the three potential block grant categories should depend on a state's interest in undertaking specialized housing activity through a state finance agency, the amount of funding it receives, and identified housing needs. Funding levels for entitlement and non-entitlement areas will reflect relative housing needs throughout the state as determined by HUD through a fair share formula.

CSHA's Analysis and Position

An amount of funds would be subtracted at the out set from the states' allocation and set aside from the total pool of block grant funds allocated to a state if that state has an established housing finance agency. Housing Assistance Block Grants must include a housing production component to be administered by states. Funding equal to 30% of the total pool of block grant funds allocated to a state and administered by HFA's would be reserved for statewide housing rehabilitation, new construction activities and special projects throughout the state. Remaining funds would be allocated to entitlement cities and non-entitlement areas. Cities large enough to meet their housing needs with available funds would receive direct allocations, based on an individual city's portion of the state-wide housing need. The share of funds for smaller cities (those that lack sufficient resources for implementing a balanced housing program) and for the remainder of the state, would be administered by the state on behalf of the localities whose needs are being addressed. The state wide agency responsible for the administration of this portion of the funds may or may not be the housing finance agency.

Entitlement city activities undertaken by entitlement cities should include but need not be limited to housing stock maintenance and any new construction projects identified by local studies of need. With its share of the funds entitlement cities would carry out such projects and may be assisted in meeting these needs by HFA's utilizing either the funds specifically set aside at the out set for HFAs for these purposes or by utilizing all or some portion of the funds set aside for entitlement cities. Use of such funds would be preceded by a cooperative analysis and mutual agreement of those projects to be undertaken between the entitlement city and the HFA.

As funding levels decline, however, the number of entitlement cities will also decline because reduced subsidies will make it impossible for cities with small allocations to engage in needed housing conservation and new construction activities.

Concept: Local Housing Assistance Plans

Funds directed to entitlement cities should be disbursed by those cities according to locally-determined housing plans. These plans should reflect goals for maintaining housing stock, new construction, and the distribution of housing vouchers. State housing finance agencies would provide financing and technical assistance to cities that request state aid.

CSHA's Analysis and Position

Cities with the capacity to address their housing needs should direct their own programs, with assistance from states when needed. If a city's housing resources cannot implement a balanced housing strategy, however, its entitlement designations would be withdrawn and its status and funds should be folded into state activities for non-entitlement areas.

Concept: State Allocation Planning

Programs in non-entitlement areas should be administered by states in consultation with representatives from local and regional governments. Criteria for ranking proposals and reviewing funded activities will be established to assure compliance with local and regional housing plans.

CSHA's Analysis and Position

Block grant principals in support of local control call for local involvement in the decision-making process. The scarcity of funds, however, will prevent attention to all housing needs identified by non entitlement communities. States should have the flexibility to choose their programs within the limits marked by local affirmations of need, and guided by objective ranking criteria.

Concept: Funding Term

Contract authority should be given on a long-term and short-term basis. Some of the annual contract authority should carry with it a long-term commitment to insure the viability of financing certain types of projects. Assurance should be given that block grant funds will continue to be authorized at least for three-year funding periods.

CSHA's Analysis and Position

Some projects will require a commitment of long-term budget authority, while others can be completed in a shorter period. A three-year commitment to block grants would allow states and cities to develop effective and efficient programs.

Housing Assistance Block Grants should be introduced gradually, easing the transition from established programs to new initiatives. Demonstrations that test program ideas and financial efficiency should begin in some states during this fiscal year.

Policy Guidelines

Federal restrictions should be limited to essential implementation items if block grants are to accomplish their fundamental purpose of providing program flexibility through reduced regulations. Assuring attention to low income families and mortgage insurance for high risk areas are two important policy objectives that Congress should reaffirm. The regulations for implementing these policy objectives, however, should be revised.

Income eligibility standards should be revised because of the need to encourage program innovation. Opportunities seldom grow under rigid conditions. Congress can still accomplish its goal of targeting low-income families while reducing the percentage of funds that must be directed to them. A minimum of one third of the total block grant funds should be reserved for people with incomes below fifty percent of an area's median income level. The remaining two thirds should support housing objectives, such as urban revitalization and economic integration, that may benefit a wider range of income groups.

Private mortgage insurance will not be readily available to many low income urban areas. These high risk areas, however, do need full insurance coverage to achieve feasible project financing. Moreover, to promote efficient and responsible housing management, state and city bonding authorities should be expected to assume some risk for projects they finance. Outside of high risk areas, co-insurance should be available when mortgage guarantees are needed. Co-insurance would free project developers from onerous FHA regulatory burdens and subject them instead to the healthy restraint of self interest. The benefits to HUD of this self-interest would continue for the life of the projects.

Current standards for affirmative action and equal opportunity, housing quality and environmental review remain valid and should continue in force.

HUD Role

HUD should have the following duties under housing assistance block grants:

*Make funding allocations to states and entitlement cities.

*Monitor housing programs in entitlement cities and states to assure that funding decisions reflect local needs.

*Review housing programs in states and entitlement cities for compliance with national policy directives.

*Review national program performance and disseminate to paticipants information about particularly successful and innovative program designs and financing techniques.

II. STATE HOUSING FINANCE AGENCY ADMINISTRATION OF A HOUSING ASSISTANCE BLOCK GRANT PROGRAM

State housing finance agencies (HFAs) have proven themselves capable of delivering a wide range of housing programs. Experience, administratiave ability and a solid record of achievement all point to a major role for HFAs in a housing block grant program. Tax-exempt financing (assuming its continued availability) could provide an important compliment to block grant funds.

Let us assume for the moment that Congress has enacted a housing block grant program and that state housing finance agencies have been given the responsibility for administering a significant portion of the funds. How will HFAs use the block grant dollars? What kinds of programs can we expect to see?

Before embarking on new programs, each state should be required to undertake a detailed analysis of housing needs. This follows logically from the argument for block grants that, unlike categorical grants, block grants allow for a mix of programs most responsive to state, regional and local conditions. This needs analysis will provide an opportunity to evaluate the state's housing stock, as well as the ability of its residents to afford adequate housing. It can help to establish a direction for new program development, demonstrating where new construction is needed, where rehabilitation makes sense, and to what extent housing needs can be met through the existing stock.

HFAs seem particularly well suited to undertake this kind of analysis, not only because of their familiarity with housing needs across the state, but also because housing markets typically transcend local boundaries. HFAs are close enough to understand local market conditions, and are capable of balancing local needs with regional and statewide housing goals.

The choice of programs under a housing block grant will be determined not only by needs but also by goals established in each state.

Local preferences will also influence the choice of programs. Historically, state housing finance agencies have demonstrated the capacity to work effectively with local governments to design programs which reflect local preferences. In some cases, the HFA and local units may cooperate on joint programs; for instance, community development block grant and housing block grant funds may be combined in one program. Local units may even administer their own programs using state block grant funds. HFAs would select among competing programs and monitor performance.

Given the flexibility, HFAs can be expected to respond to these needs, goals, and preferences with a wide range of programs. Housing assistance block grants (HABG) may go to support rental programs—both housing stock programs and income programs—as well as homeownership, home improvement, and special housing programs. A selection of program ideas follows. We note, however, that many of the ideas presented are already functional in many states as HFAs have always been independent of the federal government. Many state agencies have ongoing programs and could piggyback HABG funds. These programs could become that much more effective by gaining from the immediate leveraging provided by HABG funds.

RENTAL HOUSING PROGRAMS

Many state HFAs have experience in the administration of rental housing programs, not only in new construction and substantial rehabilitation, but some also in existing housing. Several states are embarking on moderate rehabilitation programs. With a housing block grant, HFAs would be fully capable of administering a range of rental housing programs to meet state housing needs to maintain or supplement tax-exempt financing programs, to leverage other sources of revenue in support of rental housing, and, of course, to administer direct grant programs.

Adding to the Rental Stock: New Construction and Substantial Rehabilitation

Over the years state housing finance agencies have developed the capacity to leverage private capital with federal and state funds to finance needed multifamily housing for families, senior citizens and special populations. This housing has been met with broad public approval. Having to meet strict public disclosure requirements and auditing procedures, and with a substantial performance record behind them, state agencies have gained widespread acceptance by the entire investment community.

State agencies have most often been pioneers in delivering various multifamily programs to the citizens of their states not served by traditional market programs. Great capacity has been developed by state housing agencies in the difficult areas of underwriting procedures, developing construction costs and building design standards, using innovative financing techniques, supervising the construction process and overseeing the management of multifamily properties once they are occupied. The fact that these skills have been acquired over a considerable period of time means that state agencies represent a valuable national delivery resource that is indispensable to producing multifamily units.

The question of how multifamily production can best be achieved under a block grant program is one of extreme importance. Housing Assistance Block Grant funds could be utilized by HFAs as a flexible resource to produce needed multifamily housing. Let us now describe some specific approaches state agencies might take.

- Block Grants to Lower Borrowing Costs

  A HABG might be used to write down the front end costs of a loan to make projects feasible for low and moderate income renters. For example, block grant funds could be used to reduce costs associated with land acquisition. At a time of high interest rates, block grant funds could be used to write down interest costs on tax-exempt issues offered by HFAs which would reduce overall project costs and ensure the projects economic feasibility.

- Block Grants to Provide Rental Assistance

  HABG funds can be used to lower borrowing costs as described above; however, there will be a significant segment of the population who would not be helped in this manner. HABG funds could also be used by HFAs to provide rental assitance payments to the truly needy such as the elderly on fixed incomes or the developmentally disabled. Such assistance would require the appropriation of long-term budget authority to maintain these units for low income persons.

- Block Grants to Provide Insurance

Some state agencies have historically used federal insurance to guarantee loans made to finance multifamily housing construction. However, HABG funds could be used by HFAs to create or leverage an insurance fund to support various types of loans for multifamily housing. This insurance fund could be used to reduce borrowing costs and would enhance the feasibility of many multifamily projects. Co-insurance, which could involve a state agency sharing a certain percentage of the risk of a loan, represents yet another potential use for HABG funds.

- Block Grant Funds to Provide Seed Money

HABG funds could be used by HFAs to establish revolving loan funds or grants for nonprofit sponsors and/or minority development firms. HFAs could make funds available to reduce many of the essential preliminary costs associated with project development. Use of HABG funds in this case would reduce overall development costs, thereby making the completed project affordable to a wider number of persons, and would also enhance the ability of nonprofit/minority sponsors to secure needed working capital.

Preserving Rental Stock: Moderate Rehabilitation

Much of the nation's rental housing is basically sound, but in need of moderate repairs to make it more energy efficient and to prolong its useful life. Moderate repairs are also required in some cases to maintain or achieve code compliance. This housing ranges in size from single family detached dwellings, most prevalent in rural areas, to large highrise buildings, located primarily in urban and suburban communities. A significant portion of it is occupied by low and moderate income tenants. State HFAs have valuable experience in loan underwriting, housing rehabilitation, housing management and administration of rental assistance programs which makes them particularly well suited for the operation of moderate rehabilitation programs. Program benefits could be linked to the type or income of the tenants and could include the following options:

- Block Grants to Lower Borrowing Costs

HABG funds could be used as no interest participation loans to reduce the size of the monthly principal and interest payments. Repayment could be amortized or deferred. HABG funds could also be used to lower the interest rate on the loan, either for the first few years or for the term of the loan.

- Block Grants to Provide Rental Assistance

Even when borrowing costs are low, it may be difficult to make moderate rehabilitation work for low income tenants. HFAs could use block grant funds to provide rental assistance similar to the Section 8 program, and therefore guarantee a sufficient stream of income to pay the cost of improvements.

- Block Grants to Increase the Availability of Insurance

Current FHA Title I regulations limit insurance to buildings which are owned by an individual as opposed to a partnership, corporation, etc. Other limits are set for the maximum total loan amount and the per unit amount (the FY '82 HUD authorization would raise these to $43,750 and $8,750 respectively). No other feasible insurance program exists to fill the gaps. HABG funds could be used to provide insurance or to provide co-insurance in conjunction with a private mortgage insurer, perhaps as a cooperative effort among several state HFAs.

- Block Grants to Create Rental Units

HABG funds could be used to finance the creation of rental units within existing single family homes. The funds would be used to reduce interest rates, provide a deferred or participation loan to lower the monthly carrying costs or to subsidize the rents of tenants meeting prescribed eligibility criteria. Loans could be targeted to specific population groups, such as the elderly, to specific areas with a shortage of rental housing or to particular types of underutilized housing such as large, turn of the century, single family homes.

Expanding Access to Rental Housing: Vouchers

Extensive public debate is taking place on the relative merits of various income transfer programs designed to enable low income renters to occupy decent housing without spending a disproportionate share of their income on rent. Regardless of the approach that is eventually adopted, state HFAs can play a central role in the administration of such a program, thanks to their technical expertise, staff capabilities, statewide delivery systems and financial accountability.

HOMEOWNERSHIP PROGRAMS

Existing cooperative relationships with banks, savings and loans, and local housing authorities provide HFAs with efficient mechanisms to serve rural, suburban an urban needs. Home mortgage programs financed with tax-exempt bonds were initially designed for moderate and below moderate income homebuyers, but current high interest rates have placed these funds beyond their reach. HABG funds can be used to supplement current tax-exempt bond financing to reach more effectively lower income households and others with special needs (such as first time homebuyers, large families, minorities, and the handicapped). Leveraging could also occur with funds from other sources, such as private mortgage capital, taxable securities, pension funds and state appropriations. Programs could be designed so that funds revolve to serve a larger number of households. Examples of program options follow:

- Block Grants to Reduce Monthly Costs

HABG funds could be used for graduated payment mortgages, to lower monthly payments in the early years of the loan. No interest participation loans would also decrease monthly payments by reducing the size of the interest bearing mortgage loan.

Block grants could be used to write down the interest rate or reduce the size of the downpayment under a shared appreciation mortgage program. This approach holds considerable promise for attracting pension funds and insurance funds into housing production, not only for single family homes, but for condominiums and cooperatives as well. Through a private placement with a pension or insurance fund, state agencies could raise taxable proceeds which could be utilized to finance new housing. In exchange for sharing in the appreciation of the mortgages, the pension or insurance fund would accept a rate of interest well below the prevailing rate, which would translate into reduced borrowing costs for both state agency and homebuyer.

- Block Grants to Provide Downpayment Assistance

HABG funds could be used to provide downpayment assistance to first time homebuyers. Downpayment assistance could take the form of outright grants, deferred loans payable at time of sale with or without interest, second mortgage loans repayable in small monthly payments (e.g., $10 to $20 per month), etc.

- Block Grants to Encourage Turnover in the Existing Stock

HABG funds could be used in a two step program to encourage better utilization of the existing housing stock. High density, energy efficient new construction would be provided in existing neighborhoods for "empty nesters" who are "over housed". Their homes would, in turn, be sold to young families with children, expanding the housing mix in the community and better utilizing existing infrastructure and municipal services. Block grant funds could be used at several points in the process, including construction loans or home purchase assistance.

- Block Grants to Help Renters Become Homeowners

Lower income families are often precluded from purchasing a home because of the absence of a downpayment, limited monthly income, a poor credit rating or an indequate credit history. Local housing authorities could be selected to administer a program whereby potential homeowners could rent an existing unit for several years. During that time, they would build up sweat equity through maintenance and repair. Part of their rent could also be credited towards equity. Once they had established a good credit history and built up a reasonable downpayment they could purchase the home, perhaps at a value established upon initial occupancy. HABG funds could be used to cover part or all of the initial purchase price, to pay for carrying costs during the rental period or to provide a guaranteed source of affordable takeout financing.

- Block Grants to Help Indians Become Homeowners

Indians residing on reservations are often precluded from obtaining mortgage loans because of the inability to obtain individual, clear title to the land. HABG funds could be used for direct loans or for mortgage insurance in such cases.

HOME IMPROVEMENT PROGRAMS

Nationally, annual production of new units is a significantly small percentage as compared to existing housing stock. This means that almost all Americans live in existing housing, with a wide variety in age, condition and quality. This housing stock must be preserved and sometimes upgraded. Home improvement programs serve diverse needs including preservation of existing neighborhoods, energy conservation, code compliance, handicapped accessibility and room additions. HFA capacity to administer these programs include an experienced planning capacity, a statewide delivery system and an ability to leverage funds. Options for use of HABG funds include the following:

- Block Grants to Reduce Monthly Costs

HABG funds could be used to lower the interest rate on home improvement loans to make them affordable to lower income families. The interest rate could be the same for all borrowers or linked to variables such as income or family size.

Block grants might also allow for a long term, small payment program, to make home improvements affordable to owners who can manage only very small payments of approximately $10 or $20 a month. This kind of program would be especially beneficial for the elderly. HABG funds could be used to pay the administrative and servicing costs of these otherwise uneconomical loans.

- Block Grants to Defer the Cost of Home Improvement

  Block grants could be used to provide low income homeowners with interest free or low interest loans which are repayable when the property is sold or transferred.

SPECIAL PROGRAMS

Congress has long recognized the need to create separate programs or set-asides to serve population groups with special housing needs. These include the elderly, the physicially and mentally handicapped, large families, single part families, migrant workers and people in need of temporary shelter. Many HFAs are already operating special programs, which could be expanded or reproduced in other states with the help of HABG funds.

- Block Grants to Support a Congregate Housing Program

  Many elderly are forced to live in nursing homes even though they do not need round the clock medical care because they are unable to obtain the limited support services they need to keep them independent. HABG funds could be used in conjunction with other rental production or assistance programs to provide financing for additional construction costs (e.g., kitchen and dining room) and equipment (e.g., dishes, silverware, tables and chairs). HABG funds could also be used in conjunction with social service funds from other sources to fill the gaps in providing support services such as hot meals, housekeeping, personal care and transportation.

- Block Grants to Provide for Revenue Mortgages

  Elderly homeowners often have limited monthly incomes, but significant equity in their homes; many own their homes free and clear. HABG funds could be used alone or in tandem with other funds to provide a variety of reverse mortgage instruments.

- Block Grants for Innovation

  HABG funds could be used to stimulate innovative ideas in the areas of design, construction techniques, energy conservation, marketing and finance. These demonstrations could be carried out directly by the HFAs or by other entities such as local housing authorities, non-profit organizations and limited dividend developers. Assistance could take the form of grants, short term loans or interest reductions.

- Block Grants to Support Emergency Shelters

  HABG funds could be used to provide temporary housing for people with urgent needs which are expected to be of short duration. Examples include battered women and children, migrants seeking permanent employment, recently released prison inmates and people whose homes have become suddenly uninhabitable due to furnace blowouts, frozen pipes, fires, etc.

- Block Grants to Support Group Homes

HABG funds could be used to provide direct loans, loan guarantees or interest reductions for group homes for people with special needs such as the handicapped, the mentally disabled, and people recovering from drug dependency.

SUMMARY

HFAs have historically demonstrated a capacity to provide housing of superior quality; housing which meets the diverse demands of a particular state. Housing developed and financed by HFAs have met rigorous market feasibility tests, and have been well managed and maintained. HFAs have been innovators in the housing field and have also demonstrated the capacity to work with and to efficiently implement federal housing programs, such as the Section 236 program and the Section 8 program.

As we have outlined above, HFAs have given a considerable amount of thought to what appears to be the shift away from catagorical programs designed specifically to meet certain demonstrated needs toward an all encompassing block grant approach. As we have seen, were HFAs given the responsibility for administering a significant portion of the HABG funds, alone or in cooperation with entitlement cities or nonentitlement jurisdictions, they would be able to serve the many and diverse needs of today's housing market. As has been demonstrated, state HFAs are in a particularly unique position relative to their experience, technical capacity and knowledge of the housing market, to administer HABG funds with an emphasis on efficiency and effectiveness.

Mr. Ritchie. First, Mr. Chairman, I would like to thank both the chairman and Senator Dodd for the legislative initiatives, which I think have taken a long step to putting on the front burner to giving a real priority to the need to do something for housing today in this country. The housing industry is in the third year of its slump. The downturn in housing construction which began in the late summer of 1979 has grown worse over the passing months. Over 1 million construction industry workers are now unemployed. This represents approximately 10 percent of the total unemployed in the country. It is greater than the unemployment in any other industry. Conservative estimates of household formation losses to the existing stock and necessary vacancy allowances indicate that we will need about 2.45 million new housing units during the decade of the 1980's, if we are to maintain the present levels of housing quality. If present trends persist, we are unlikely to have annual production this year that is much higher than last year's dismal level of 1.08 million starts, which is the lowest production level we have had since World War II.

The implications of this production shortfall are clear. Across income levels, renter and first-time home buyers will face a rapidly falling standard of living as prices for housing units will be bid up—where units are available. Only people who presently own homes will be unaffected, if they are required—if they are not required to move, and if their housing needs do not change.

The housing prospects for households at the lower end of the income scale are deteriorating. Rental shortages are forcing middle income households to compete directly with lower income renters for units. We are seeing, in effect, not only a gentrification of neighborhoods but also a gentrification of modern income rental developments.

The many problems facing the housing industry require that Congress take action on a number of fronts. Traditionally, the administration's housing bill has been the focus for the discussion of comprehensive strategies to address the Nations's housing needs. This year many issues, such as the need for low-income rental housing production and the need for construction industry stimulus are not addressed or receive very inadequate treatment in the bill. In the focus of this bill, the administration's housing bill involves a modified section 8 existing program. Based on the experience of State housing agencies, including our own, which currently administer the section 8 existing program, and find it to be highly successful, we feel that the old saying, "If it is not broke, don't fix it," is very relevant. We prefer the section 8 existing program over the proposed modified section 8 existing program.

KEY HOUSING POLICY ISSUES

Now Mr. Chairman, I would like to comment on a number of key housing policies issues which the Nation faces this year. First, reserving existing low-income rental housing stock. Congress must take the necessary steps to insure that existing Government-assisted housing, the only affordable option for millions of low income households will be adequately maintained. Although default rates on rental housing have been the lowest for Government-assisted housing, CSHA supports the continuing funding of the flexible funding subsidy program to assist both insured and noninsured section 236 projects as an efficient means to place marginal projects back on a stable financial base.

Second, building the units which Congress already has budgeted and appropriated. Presently there are as many as 100,000 units in the multifamily production pipeline. These are units that have been appropriated by Congress, but have not been built because of high interest rates. State FHA's alone have as many as 34,000 section 8 units in the pipeline. Financing of the pipeline not only will provide much needed low income rental units, but will also provide an immediate shot in the arm for the residential construction industry with little or no additional budgetary impact. To get the pipeline going, Congress must raise the financing adjustment factor for bond-financed projects to reflect present market interest rates and extend the construction start deadline for financing adjustment factor eligibility past the June 1 date.

Finally, nonfinancing adjustment factor amendments must not be arbitrarily capped without authorization. Many projects will not be workable even without a financing adjustable factor. We're very concerned that the administration had not addressed this key issue in its proposal. We understand that Secretary Pierce will announce his recommendations regarding the financing adjustment factor today, and we look forward to reading what those are.

Third, to keep bond-financed rental production a possibility, Congress must reject the administration's industrial development bond project as it applies to multifamily housing bonds. This would prohibit accelerated depreciation of bond-financed rental units. Because of this provision and additional restrictions proposed by the administration, rental housing bonds would be effectively terminated for multifamily projects. Congress, following extensive study and debate, passed the Mortgage Subsidy Bond Tax Act. The administration, 16 months later, is proposing additional restrictions on rental housing bonds. These restrictions must be rejected.

Fourth, Congress must make workable the $15 billion annual single-family mortgage bond program they authorized in 1980. Because of the unworkable restrictions of the Mortgage Subsidy Bond Tax Act, less than $2 billion in single-family bonds were sold under the provisions of the act last year. Congress should pass H.R. 4717, a bill which includes amendments proposed by Senator Durenberger to the Mortgage Subsidy Bond Tax Act that should go to conference very shortly. However, for housing bonds to be self-supporting, it is critical that the allowable yields for revenue bonds be raised to 1¼ percent. With this arbitrage level and a leveling off of interest rates, interest that we anticipate at $10 to $15 billion in housing bonds could be sold this year. This volume would directly finance 185,000 moderately priced homes at below market rates. This volume of housing bonds would create 330,000 man-years of housing construction, related employment and generate $1.8 billion in local, State and Federal taxes.

Housing bonds are not a panacea for the housing industry, but there is no question that a workable bond program could be quickly implemented. The cost to the Federal Government has already been counted. While Congress evaluates the numerous housing industry stimulus proposals that have been introduced, such as that of the chairman and Senator Dodd, we could have immediate relief by providing funding for first-time home buyers.

Congress must seek options and partnerships for the low- and moderate-income housing. The administration bill attempts to address the problems in the rehab proposal. The Council believes the program does not adequately address the needs for preservation and rehabilitation of the rental stock and would prefer Senator Dodd's approach with some minor modifications.

The reliance on State and local administration in S. 2171 and the flexibility of the program are definite improvements over past Federal rental housing programs. In addition, the recognition of the value of mixed income projects is an important aspect of this program. We would, however, suggest elimination of the priority for projects with the greatest amount of low-income units, since this is a housing supply program, rather than an affordability program.

We further recommend that funding not be done on a project-by-project basis. A Federal fair-share approach would insure the allocation of funds to rural and other underserved areas. Effective support programs, such as coinsurance would add to the workability of the program. And it must be made clear that the program is compatible with tax-exempt financing to insure that State and local governments will be able to leverage limited Federal dollars.

With modifications noted above, the proposed production program could efficiently stimulate the production of low- and moderate-income rental housing and be adaptable to the special needs rural households, the elderly and handicapped individuals.

In conclusion, the crisis in low- and moderate-income housing requires strong action by Congress, not only to meet the pressing economic and housing needs, but to put in place a system that will address these needs for years to come.

The Council of State Housing Agencies looks forward to working with the chairman and the entire committee. I would be happy to answer any questions you might have.

Senator LUGAR. Thank you, Mr. Ritchie. Senator Dodd, do you have questions for these witnesses?

Senator DODD. Very briefly, Mr. Chairman. I appreciate the witnesses' testimony this morning.

Mayor, it is a pleasure to see you here this morning. I am particularly pleased with your testimony. You have mentioned an impressive array of programs that you are engage in in St. Paul. I wonder if you might address what other things you have done out there. I do not know if you've done anything in the area of mortgage revenue bonds and so forth, but to involve—the issue we are hearing over and over again, and one I think we've all come to recognize and agree with, is local input, local involvement. In fact, the one line in your testimony that no one lives in a national housing market, everybody lives in a local housing market, is a very salient point, I think. I wonder if you might address some of the other things you have done, as well.

BELOW-MARKET INTEREST RATE

Mr. LATIMER. Thank you, Senator. And Mr. Chairman, before Ullman, we used the below-market interest rate in revenue bonds, and we produced 917 units. We are really proud of that and when the Ullman legislation was debated, we offered our experience. We are assured by everyone that if we could make revenue bonding work it should be in the targeted way we made it work. The average adjusted gross income was somewhere around $21,000, the average age of the applicant was 28 years old. The families were new young families left out because of interest rates. Well-targeted, we thought. And I think it is very unfortunate that the baby did get thrown out with the wash.

We also had a below-market interest rehab program that achieved pretty much the same kinds of results, and then, thirdly, Senator, I agree both with Senator Lugar and your approach, in a sense that there are—there are many things we can do locally. Right now, St. Paul and Minneapolis, in a marriage, if not made in heaven, certainly one that is rare in its consummation between our two cities, we got our first urban development action grant to two cities, combined with a foundation fund, which achieved at the McKnight Foundation a funding level for young families of moderate income, exactly the kind of new construction that would be contemplated, I think, by the stimulus bill that Senator Lugar's talking about.

We recognize, that—and great benefits came from that. We have 900 units under construction right now during a period of tremendous desperation in housing, and we recognize that those tools that I have just highlighted were valuable in stabilizing our community and opening up housing opportunities for young families who are working. We do not pretend that we achieved targeting through those tools. We achieved targeting through other means, section 8, and the other means, but I do think it is part of an all-incomes kind of policy that cities can go forward with under your notion of a block grant program.

I might say—I do depart from the last exception that was made. I think we all need to keep our eyes on the ball about targeting. I think any incentives you build in there—you hear mayors all over the country also talk about deregulating, but the fact is that those kinds of targets and incentives are proper. They are going to insure that the national purpose is going to be served, where pure politics on a local level may not support it.

So I would really support you very strongly in keeping those kinds of incentives in there to reward the targeting aspect of any housing program.

Senator DODD. I cannot resist, since you talk about marriages being made in heaven with St. Paul and Minneapolis, my parents were married in St. Paul. My five brothers and sisters and I thought that was a marriage made in heaven.

Mr. LATIMER. It is heavenly, that's true.

Senator DODD. You have touched on this already, but as you know, the administration proposal is, in effect, I think another member of the committee, maybe Senator D'Amato, I'm not sure if he's introduced it or not, but he is talking about a moderate rehab bill as a way of dealing with production. That legislation, that I've introduced, you were generous in your prepared testimony to comment about, S. 2171, the Rental Housing Production Rehab Act, I include that as well, but add to that substantial rehab and new construction, depending upon the local needs, in effect, allowing greater flexibility at the local level, based on what their own particular needs would be and then targeting it, so that we are really getting at the particular problem that exists and not seeing the dollars squandered where you have had legitimate complaints in the past about some of these monies going to questionable recipients in terms of their actual need.

FLEXIBILITY AT THE LOCAL LEVEL

You commented, but I wonder if you would comment further, that the importance of flexibility at the local level, while also having the targeting approach, what are your——

Mr. LATIMER. Yes, sir. Mr. Chairman and Senator, it is very difficult to criticize an approach which assures some targeting and also some flexibility. My fear, and I must be very plain and blunt about this, relative to your total budgetary problems that are so severe, and I completely empathsize with the task before you, is that many of the newer ideas are very intriguing, very worth pursuing, but we really violate our national housing commitment, if we basically take those moneys out of programs presently targeted without an adequate replacement.

There is no way of sugarcoating that. The desparate, the poor, the unhoused have only this Congress and this Senate to represent its interests—for a variety of reasons, not the least of which are legal and realistic financial constraints at the local level. Before you deal with the competition for funding for other needy projects at the local level, I do not think flexibility should be used as a way of avoiding the absolute necessity of having some long-term financing commitment for housing which will not get built because of the market alone.

We have had a wonderful time in St. Paul in the last 6 years that I should mention to you, if I failed. Not one single unit of moderate rental property without subsidy has been built in those 6 years, not one unit. The market is not there. Any honest analysis will tell us it is not there.

We do have, by the way, high-priced condominiums that are going up right in our downtown. The market is there—high-priced rental, the market is there. Even yet, for that——

Senator DODD. Let me mention as well—I mentioned the moderate rehab as part of the program and also the voucher system. As I am sure you are aware, under the voucher system, as proposed by the administration, there can be no cost-of-living adjustment in that voucher. It is a static figure. And it occurs to me that if you combine voucher with moderate rehab, so that actually by improvements to the unit you are going to raise the cost of that unit, isn't it an exaggeration to suggest that you could actually create displacement despite the good intentions of the administration by trying to address the affordability issue through the voucher program, addressing the production problem by moderate rehab?

But, in effect, the very person we are trying to help with the cost of rent and increasing the availability of stock, in fact, we may push out. Is that an exaggeration?

Mr. LATIMER. Yes. It is not an exaggeration.

Mr. Chairman and Senator, my response was a little overboard to your question. The flexibility at the local level between new construction and rehab has to continue because there is such a great variety in need around the country between those two needs. I do not think that we should rob from that particular Peter to pay Paul.

Senator DODD. Could I ask you to comment on this, Mr. Scott and Mr. Ritchie?

Mr. RITCHIE. I was following, as you read along in your testimony, and you neglected to read one line here, which I do not know whether I should thank you for or not.

Mr. Chairman, I'm quoting from page 6, where he endorses the bill that I have submitted. He then goes on to say, Mr. Chairman: "This is more consistent with the spriit of new federalism as it relies on State and local government."

I appreciate that comment. I do not know whether others would associate my feelings with new federalism. I appreciate your comments on the last question, both of you.

Mr. RITCHIE. I wonder if you would repeat the question.

Senator DODD. It has to do with—I do not question the intent of the administration at all. We are dealing with one area of the Federal budget. We are dealing with a whole budget. We have problems here with it, obviously. But this committee is charged with the problem of trying to deal with the housing problem, and we're trying to do what we can under those constraints.

VOUCHERS AND MODERATE REHAB

The administration has put forward a two-part program to deal with affordabiltiy and production. The affordability answer is vouchers, and the production answer is moderate rehab. That is basically the program.

I do not really have any problems with either one. My problem is I do not think that it really takes in the totality of the problem. And my concern is, in fact, with just those two programs, with vouchers and with moderate rehab—and if you understand, as well, under the administration's proposal, there is no room for increasing what you will receive under a voucher as a result of normal rent increases. What you receive under the voucher is a flat rate.

Now, if you have a moderate rehab program and you increase the value of the unit and you have a recipient of the voucher living in that unit and the costs go up, aren't you, in effect, running the risk of creating displacement of the very individual that the program is designed to assist?

Mr. RITCHIE. I think that is a very cogent analysis of the problem.

I think what we have seen in the rental housing assistance programs has been the operating costs have increased on an annual basis, and the inability of the residents to accommodate to those increased operating costs is then the root of the problems that many of the 236 projects have faced.

On the other hand, in operating a moderate rehabilitation program—and I think we have one of the more successful moderate rehab programs at the present time, using the section 8 program—we have found that, to get the landlord interested in that program, there must be some assurance that he will have a continuing market for that unit if he is going to make the economic decision to invest the funds necessary to make the improvements.

And if he is told that the market is going to be limited to one tenant who is going to have a very restricted income, with no flexibility, it is going to be much less interesting to the landlord to participate in that program.

Senator DODD. Mr. Scott.

STATEMENT OF JIM SCOTT, SUPERVISOR, FAIRFAX COUNTY, VIRGINIA NATIONAL ASSOCIATION OF COUNTIES

Mr. SCOTT. I do not think I can improve upon the comments of the other members, and I apologize for being late.

Senator DODD. That's fine. You are forgiven.

Let me ask this. This has to do—again, you have commented a bit, Mr. Ritchie—and maybe I will address it to you, Mr. Scott—I do not know if you've had a chance to look at S. 2171, which is the proposal that I have introduced—it has been introduced in the House as well— dealing with the whole question of production and trying to recognize that each locality has different needs. And moderate rehab may be one of them, substantial rehab may be another, new construction a third.

And then, giving localities the opportunity as to how they want to use those funds, whether it is a buydown or other vehicles which they may find to best address their needs, targeted specifically to that community and the hardest hit areas, that is the idea, but providing the flexibility, not limiting it just to moderate rehab. My feeling is that moderate rehab may address the problems of some communities, but it will be totally inadequate in others.

I wonder if that is a correct assessment on your part as well?

Mr. SCOTT. Senator Dodd, I would like to request that we enter the National Association of Counties testimony into the record.

Senator LUGAR. It is my intent to call upon you as soon as Senator Dodd has finished questions. Then we will ask you to summarize your statement, and then we will enter your statement into the record.

Mr. SCOTT. Senator Dodd, our testimony does deal to some extent with your proposal. And I think we are, in general, quite favorably impressed with the proposal that you have made. It is comprehensive, more comprehensive in nature, and deals, I think, with the problems as we see them throughout the counties, particularly the urban counties in the United States.

We think the program which does provide some production is very important for families of low and moderate income, as well as for the elderly.

Mr. RITCHIE. I would mention that our only reservation with regard to the priority for the higher percentage of low income is the limited resources that will be available. And our concern is that if there is a mixed-income project, those resources can be spread much farther than they can if there is—if restricted to all low income.

In addition, it has been our experience that the mixed-income projects create successful housing communities and, indeed, that the community in which they are located is frequently much more receptive to a development that features the mixed income.

Senator Dodd. That was the rationale for it.

I happen to believe that one of the problems we get into is warehousing people by economic condition and that nothing is more detrimental to a neighborhood or to a community than to warehouse certain classes of people. And if you can create an economic mix, that you are not only, I think, going to have a greater likelihood of construction and development, trying to lure the private sector in, but you'll end up with a better community. The mixed neighborhoods generally are healthier neighborhoods.

And so, there is both an economic rationale for it—but unless I am wrong, I think a worthwhile societal achievement is reached as well with that mixed-economic base, if you will, in these projects.

Mr. Chairman, I thank you for allowing me so much time with questioning.

Senator Lugar. Mr. Scott, would you give your summarization at this point.

[The complete statement follows:]

Statement of Jim Scott, Supervisor, Fairfax Countery, Va., on Behalf of the National Association of Counties

Mr. Chairman and members of the subcommittee: On behalf of the National Association of Counties (NACo),[1] let me thank you for inviting our testimony before this Subcommittee on the Annual Housing Authorization Legislation.

I am Jim Scott, a supervisor for Fairfax County, Virginia. I am also chairman of the Community Development Steering Committee of the National Association of Counties.

Mr. Chairman, NACo is keenly aware of the current budget situation and the need to restrain Federal spending. However, as you know, in fiscal year 1982 State and local government programs, which represent approximately 14 percent of the total Federal budget, absorbed 66 percent of the cuts proposed by the President and adopted by the Congress.

While the full impact of these cuts (including cuts in programs under this committees's jurisdiction) have not been totally realized, there is now a pervasive feeling among county governments that all of the "fat", if there was any, has been eliminated. The fiscal year 1982 Federal budget cuts have forced many counties to reduce employment, cut back on service hours and services and postpose badly needed investment in infrastructure repairs. Many counties have had to raise property or sales taxes, an action viewed most unfavorably by their citizens. Further reductions in revenues would seriously and negatively impact on the ability of counties to provide basic and vital services to citizens.

Thus, it was a great disappointment for NACo and its members to learn that the administration's fiscal year 1983 budget would cut even further into the Federal programs which counties rely on to provide for the needs of their citizens. As a consequence the board of directors of the the national assocation of counties on February 21, 1982, adoped a resolution urging Congress to impose a moratorium on budget reductions in Federal domestic programs for fiscal year 1983.

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[1] The National Assocation of Counties is the only national organization representing county government in the United States. Through its membership, urban, suburban and rural counties join together to build effective, responsive county government. The goals of the organization are to: improve county governments; serve as the national spokesman for county government; act as a liaison between the nation's counties and other levels of government; achieve public understanding of the role of counties in the federal system.

Mr. Chairman, although the issue is not directly before the subcommittee, we want you to know of our support for congressional appropriation of the full $3.7 billion for community development block grants and $500 million for urban development action grants for fiscal year 1983. If the community development and UDAG programs are to continue to be the basic building blocks of communities, enabling them to meet low income peoples' needs, it is imperative that a they be funded at the amount authorized by this committee and the Congress.

NACo is deeply concerned about the adminstration's budget and authorization request for low income housing assistance. As you know it proposes an fiscal year 1982 $9.4 billion rescission as well as another $10.4 billion recapture of funds appropriated for section 8 and public housing in prior years. NACo strongly opposes these proposals.

The budget request for fiscal year 1983 would essentially end low income housing construction, except for 10,000 units under the section 202 elderly housing program. It would also modify the section 8 existing housing program, replacing it with a "voucher type" program under which tenant incomes would rise, their food stamps would be counted as income and they would pay all of their utilities NACo also opposes these modifications to the section 8 existing program.

However, one element of the administration's proposed modification of section 8 which we think has merit is that which provides an incentive for tenants to shop for cheaper, but standard housing, allowing them to retain the difference. We would urge that this subcommittee adopt this provision as a modification to the existing section 8 program.

In addition to the section 8 existing housing program, it is essential that there be some form of Federal assistance for the construction and rehabilitation of housing for low and moderate income persons. The proposed multifamily production program embodied in Senator Dodd's bill, S. 2171 is a huge step in that direction and we urge its adoption by the Congress as part of a comprehensive housing assistance package. By use of short term Federal assistance to areas of housing shortage and providing maximum flexibility to State and local governments as to its use, it responds favorably to criticism of the present section 8 new construction/substantial rehabilitation program.

We note that one of the provisions in that bill (S. 2171) would give funding priority to those projects reserving more than 20 percent of the available units for persons whose incomes are below 80 percent of median. We would urge that the subcommittee adopt this provision and in addition impose an upper limit of 120 percent of median income for the balance of the units in a project. This would help insure that scarce Federal funds are targeted to those most in need.

In addition since Congress will extend the section 202 elderly housing program this year, we recommend that this new program be heavily oriented toward housing for low and moderate income families. We would also urge that the subcommittee consider providing a formula entitlement distribution of these funds, i.e., block grant, as opposed to a competitive grant program. Such a distribution system could make funding available to States and local governments on a predictable basis and as a companion to their community development block grants.

Mr. Chairman, I mentioned before the need for a comprehensive approach to the issue of housing. We are, of course, aware that you and others have introduced legislation to provide generally for a mortgage interest write-down on new home construction. While we certainly don't deny that there is a need to create jobs and respond to the present plight of the homebuilding industry, as well as the desire to provide homeownership opportunities to those shut out of the market due to excessively high interest rates, we must respectfully urge that any action in this area be taken only as part of a comprehensive response to the housing needs of our Nation's low income persons.

Such a comprehensive package must include adequate funding for subsidizing existing housing, assistance for new construction and rehabilitation (preferably via a block grant), adeqate operating assistance and modernization funding for the existing public housing stock and continued funding for the GNMA program. The funding levels appropriated by Congress for fiscal year 1982, in our view, are the bare minimum needed to keep faith with our Nation's less fortunate, and ill-housed people.

Thank you for your favorable consideration of NACo's views.

Mr. Scott. Thank you for your patience.

I would say that I am appearing for the National Association of Counties. I am chairman of the community development steering committee and member of the board of supervisors of Fairfax County.

Let me say that we are very much concerned about decisions that might reduce the housing program. We are interested in proposals like Senator Dodd's which would encourage construction as well as rehabilitation.

The National Association of Counties, at its meeting in February, adopted a resolution urging Congress to impose a moratorium on budget reduction in Federal domestic programs for 1983.

We have long held the position that some kind of housing assistance—the block grant idea would be useful. To that end, we are quite interested in the new proposals which provide more flexibility for localities, which a number of the proposals before the committee will do.

I will refer to my testimony and say that I certainly agree that it is a very useful objective, not only economically but socially, to have developments which are of mixed income.

I would say also that we view it crucial that housing legislation be comprehensive in nature and focus as extensively as possible on the very neediest of low- and moderate-income families.

Thank you.

Senator LUGAR. Thank you, Mr. Scott. We appreciate your coming.

Obviously, we are delighted that Mr. Ritchie came and Mayor Latimer was here for the colloquy you had with Senator Dodd.

I would like to call upon my colleague, Senator D'Amato, who has joined us, and ask whether he has questions of this panel, or even an opening statement that he would like to make at this point.

Senator D'AMATO. Thank you, Mr. Chairman, for the opportunity. I think I would be impinging upon this panel and those who are waiting to testify.

I am delighted to have the opportunity to give my greetings to those who have taken their time out, particularly as public officials, to be here and loan their input to this committee, and to the chairman, on such a vital subject area, which really reflects dramatically on the health and well-being of our communities.

Senator LUGAR. Thank you, Senator D'Amato. We thank you for coming.

The Chair now calls for a third panel, Barry Zelikson, president, Preservation Resource, Inc., of New York City, and Michael Lappin, president, Community Preservation Corp.

STATEMENTS OF BARRY ZELIKSON, PRESIDENT, PRESERVATION RESOURCE, INC., NEW YORK CITY; AND MICHAEL LAPPIN, PRESIDENT, NEW YORK CITY COMMUNITY PRESERVATION CORP.

Senator LUGAR. We much appreciate your coming this morning. It has been such a long time since the hearing commenced, let me suggest again the ground rules for testimony.

All of the prepared statements and additional tables that you might have will be made a part of the record. We would appreciate it if you would summarize your comments in 5 minutes. And then we will proceed to questioning of the panel as a whole by the Senators who are here.

If you would proceed in the order that I introduced you.

First of all, Mr. Zelikson.

Mr. ZELIKSON. Thank you, Mr. Chairman.

I am pleased to be here today to offer comments on a bill to be introduced by Senator D'Amato concerning a very important problem involving multifamily rehabilitation.

I spent many years in the housing field and have increasingly come to the feeling that it is imperative that we devote more attention to the preservation of existing housing.

As a former commissioner in New York City of the Department of Development, I initiated a housing program geared specifically to deal with existing housing and to leverage what were then, and still are, limited public subsidies.

The proposed cutbacks in Federal housing programs to assist low- and moderate-income families make it imperative that this existing housing serving this population's needs be preserved.

To quote some HUD statistics, they report that of some 26 million renter-occupied rental units in the country, 1.8 million are seriously deficient and another 2.6 million have significant inadequacies.

The continuing deterioration and abandonment of rental units is accelerating the decline of many neighborhoods. The replacement of these units involves numbers that at this point in time are almost incalculable.

Clearly, this country cannot seriously contemplate allowing this housing resource to be lost. However current economic factors are such that there is the expectation that the deterioration and loss of housing will continue.

And programs designed to treat this enormous number of properties must work on a scale commensurate with the problem and must stimulate private-sector investment to the maximum extent feasible. And any government subsidies required must be highly leveraged and kept administratively simple in its application.

The bill proposed by Senator D'Amato suggests a comprehensive approach to the problem that includes mechanisms that would allow for the treatment of large numbers of units. In fact, it has a potential that goes far beyond any stated number tied to grants or Federal vouchers.

FHA INSURANCE—TAX-EXEMPT FINANCING

I would like to discuss two provisions of the proposed bills: One, the involvement of FHA insurance, particularly section 223f. And second, the proposed use of 11b tax-exempt financing.

I think we are well aware that there is a general reluctance by lenders to provide mortgages in certain areas. Continuing neighborhood deterioration and economic pressures are not going to change the situation.

FHA mortgage insurance can be used to overcome this problem. It protects the lenders from risks and creates an access to secondary markets to permit a lender to recycle any mortgage capital it may invest.

The GNMA mortgage backed security program and tax-exempt financing are two proven and acceptable methods for gaining this access to secondary mortgage markets.

However, most FHA insurance programs are complex and difficult to use within this context. Section 223f insurance, as designed by HUD and revised for its implementation in the target area preservation demonstration in New York City and other communities, has proven to be an effective program for the moderate rehabilitation of this existing housing.

The bill proposed by the Senator would formalize and expand the special TAP program. There are several aspects of 223f that are worth noting.

First of all, there is no rigid compliance with minimum property standards. In fact, the usual time-consuming architectural and engineering reviews by HUD can be accomplished in a few days.

The insurance is provided only upon completion of construction, leaving the burden of producing an acceptably repaired building with the private sector, where it properly belongs.

HUD's risks during construction are virtually eliminated. The entire FHA review process can be accomplished by HUD in a fraction of the time normally associated with insurance under the HUD programs. This is significant when dealing with the kind of existing real estate that we are trying to focus on.

The availability of an FHA insuring mechanism would make it possible to provide financing for mortgages in neighborhoods where it otherwise might not be available.

In a typical New York City situation, the net result, using rents as projected under the HUD voucher program, would make it possible to provide rehabilitation at about $3,000 per unit, which is a very modest program by New York standards. But it does provide for a level of repair, such as a new roof, energy-efficient improvements, new windows, perhaps a new burner, that would stabilize operating expenses which have been escalating. In addition, long-term financing made available through this insuring program would be a very important benefit to the owner. Although many properties would benefit by this level of repair, clearly most others would require greater rehabilitation.

Before reaching for Federal subsidy, which is always easy to do, it is worth using the benefits of the lower mortgage interest rates obtainable through tax-exempt financing.

In the particular case cited, using again the same voucher rent limits, you would be able to increase the amount of rehabilitation possible by several thousand dollars, improving the level of rehab and improving the building accordingly.

Where Government subsidies would be required, the same tax-exempt vehicle would serve both as a source of private sector capital and increase the level of any Federal subsidies that might be required. Given current Government budget constraints, this leverage potential is very important.

The tax-exempt mechanism requires no budget appropriation. Given the magnitude of the problem that we face, it makes good sense to encourage this tax-exempt financing for moderate rehabilitation.

The proposal to allow 11b financing is potentially very useful within this context. Alternative authorization for tax-exempt financing under section 103 of the IRS Code—includes requirements that inhibit its use within existing housing in two important ways:

First, IRS rules restrict the amount of tax-exempt proceeds that can be used for refinancing. Buildings requiring modest repairs will often have high values in relation to the amount of repairs that are necessary. It is these same properties that are most suitable and cost effective to assist, without having to provide grants or deep subsidies from the Federal Government.

In addition, the Bond Subsidy Act of 1980 requires 20 percent of units be maintained for low income for 20 years. This is a difficult and cumbersome objective to achieve in the areas that we are looking to target. Moderate Income Rehab II, section 11b, which is part of the Housing Act of 1937, avoids the problems noted above.

The proposal to expand 11b to allow tax-exempt financing for eligible projects, as defined in the proposed bill, could be made into a very effective program for the financing of moderate rehabilitation. It should be noted that current HUD regulations for 11b are designed for single-project bond issues involving section 8 projects, and a major revision or alternate regulations would have to be developed.

Before I conclude, I feel it important that I touch on one additional item included in the Senator's proposal. The bill allows for a modified certificate to be made available for families at 80 percent of medium income. An alternative suggestion to limit rental assistance, to families with incomes no more than 50 percent of median would be a major program impediment. This restriction would leave a significant affordability gap for some families.

Where rents are to be established at HUD's modified certificate rent levels, these lower income limits would cause displacement problems and result in limiting projects to those currently occupied by very low income families. These projects are likely to be more expensive to repair and require deeper subsidies, thereby limiting the number of units that could be treated under the program.

In conclusion, I would urge a very serious consideration and support for the bill to be proposed by the Senator from New York.

Thank you very much.

[The complete statement follows:]

STATEMENT BY BARRY ZELIKSON - PRESIDENT OF PRESERVATION RESOURCES INC., NEW YORK CITY - REGARDING A BILL INTRODUCED BY SENATOR ALPHONSE D'AMATO - CITED AS THE "MULTIFAMILY REHABILITATION ACT OF 1982"

I am pleased and honored to be given the opportunity to comment on the very important proposal before you, introduced by Senator D'Amato.

In my twenty-two years of experience in the housing field, I long ago came to the conclusion that the preservation and rehabilitation of our existing housing is essential. I have had a good overview of housing problems in my sixteen years working for the New York City Department of Housing Preservation and Development, the last four of which I spent as Commissioner of the Department of Development. As Commissioner, I initiated the City's Participation Loan Program(PLP) which was designed to leverage public funds and involve the private sector in a rehabilitation program devised to treat existing housing. For the past several years, I have served as a consultant to developers and lenders involved in housing rehabilitation. As consultant to Citibank, I played a prominent role in the structuring and implementation of the Target Areas Preservation(TAP) Demonstration in New York City.

It is my opinion that the legislation introduced by Senator D'Amato is important and timely because it addresses a very serious problem requiring immediate attention.

Proposed cutbacks in current federal housing programs to assist low and moderate income families make it imperitive that existing housing, serving this population's shelter needs, be preserved and repaired. Various analyses indicate that it would be 20 to 70 times more cost effective for government to preserve and rehabilitate existing occupied housing than to try to replace it for low income families.

HUD reports that "of 26 million renter-occupied units, 1.8 million are seriously deficient and another 2.6 million have significant inadequacies. Continuing deterioration and abandonment of rental units is accelerating the decline of many neighborhoods." Using these HUD numbers and assuming a $50,000/du replacement cost, $220 billion would be needed to reproduce these units. If these units were to be made affordable to lower income families, the cost to government would involve numbers that are unthinkable. Clearly, this country cannot seriously contemplate allowing this housing resource to be lost. Yet current economic factors are such that there is every expectation that this deterioration and loss of housing will continue. Time does not make this problem go away; in fact, the longer one waits to make a repair, the more expensive the remedy is likely to become.

Any program attempting to treat the enormous numbers of properties needing help must be designed to work on a scale commensurate with the size of the problem. Private sector investment and lender participation must be stimulated to the maximum extent feasible. Any government subsidy required must be highly leveraged and kept administratively simple in its application.

The bill proposed by Senator D'Amato suggests a comprehensive approach to the problem and includes mechanisms that would allow treatment of large numbers of units. The potential goes far beyond any stated numbers tied to grants or modified vouchers.

Within this context, I would like to discuss two provisions of the bill:
1) the use of FHA mortgage insurance and Section 223f in particular, and
2) the proposed use of 11b tax-exempt financing.

For some time, there has been a general reluctance by lenders to provide mortgages in certain areas. Alternative lending opportunities entailing less risk have severely limited the availability of mortgage financing. Continuing neighborhood deterioration and economic pressures are taking the few remaining traditional lending sources out of this market.

FHA mortgage insurance can be used to help overcome this problem. This insurance protects the lender from inherent risks. In addition, FHA insurance can be used to access secondary markets and permit a lender to recycle its mortgage capital. The GNMA-Mortgage Backed Securities(MBS) or tax-exempt financing are two proven and acceptable vehicles that might be used.

Most FHA insuring programs are designed for use with new construction or substantial rehabilitation. Section 223f insurance, however, as designed by HUD and revised for implementation in the Target Area Preservation Demonstration, has proven to be an effective program for the moderate rehabilitation of existing housing. The bill proposes to formalize and expand the special TAP program.

There are certain aspects of this program that are worth noting:

- Although a building must be in sound condition, rigid compliance with Minimum Property Standards is not required. In fact, the usual time-consuming architectural and engineering reviews by HUD can be accomplished in a few days.

- FHA insurance is only provided upon completion of construction. The burden of producing an acceptably repaired building rests with the private sector. The construction lender and property owner must assume this risk. HUD risks and involvement during construction are virtually eliminated.
- The entire FHA review process can be accomplished by HUD in a fraction of the time normally associated with insurance under other HUD programs. This, is turn, reduces HUD administrative costs.

I must note that the potential benefit of use of this insurance vehicle will only be achieved where applied properly by HUD local area offices.

The availability of a simple FHA insuring mechanism would make some financing obtainable in neighborhoods where it might not otherwise be available. It is worth describing an example of how this might work. Using HUD's projected rents for its modified certificate as a basis for estimating gross income, a typical project in New York City would likely support a mortgage of about $7,800/du (See Exhibit A). After allowing for refinancing and associated soft costs, approximately $3,000/du might be available for rehabilitation.

This amount for rehabilitation, though modest, could provide for important major repairs or replacements that might include one of more of the following: boiler, burner, window replacements, roof, waterproofing, etc. Not only would many properties benefit from this level of repair, but the stabilizing effect of providing fixed rate, long-term financing would be of important benefit to the owner.

While many properties might be aided using the approach described above, an even greater number might require more extensive repairs. Before reaching for a federal grant, it is worth using the benefits of the lower mortgage interest rates obtainable through tax-exempt financing. In the example cited above, the same net income could support an increased mortgage that might allow $5,000/du to be available for rehabilitation. The level of rehabilitation would represent an important increase from the previous example.

Where more extensive rehabilitation and governmental subsidies or grants are necessary, the tax-exempt bonds can be used, both as a source of private sector capital and to increase the leverage of the subsidy. Since government budget constraints will limit the number of units that can be assisted, this leverage potential is important.

The tax-exempt mechanism requires no budget appropriation, though so-called "off budget", indirect costs or lost taxes can be associated with it. However, market rents will limit mortgages, and off budget costs will be very modest when compared to the benefit. Given the size of the problem we face and the current budget limitations, it makes good sense to encourage tax-exempt financing for moderate rehabilitation.

The proposal to allow 11b financing is potentially very useful within this context. Alternative authorization for tax-exempt financing for Industrial Development Bonds under Section 103 of the Internal Revenue Service Regulations include requirements that inhibit its use with existing housing in two important areas:

1) IRS rulings provide that no more than 10% of tax-exempt proceeds can be used for refinancing. Buildings requiring modest repairs will often have high values and a higher proportion of refinancing in relation to repairs than the buildings that are very deteriorated. It is these same properties that are most suitable and cost effective to assist without having to provide grants or deep subsidies.

2) The Mortgage Bond Subsidy Tax Act of 1980 requires that 20% of units be maintained for low income occupants for 20 years. Although this provision is likely to be modified, the proposed changes will still leave it difficult or at least cumbersome to achieve a 20% low income goal without multi-year subsidy contract similar to Section 8. Since this form of contract subsidy is not likely to be available beyond this fiscal year, this method of tax-exempt financing will remain difficult.

Section 11b, which is part of the Housing Act of 1937, as amended, avoids the problems noted above. The proposal to expand Section 11b to allow tax-exempt financing for eligible projects, as defined by the proposed bill, could be made into a very effective program for the financing of moderate rehabilitation. It should be noted that current HUD Regulations for 11b are designed for single project bond issues involving Section 8 projects. Major revision or alternate regulations would be required to adapt this program for multi-project, non-Section 8 bond issues.

I have commented on only two aspects of this comprehensive proposal. Many other of its provisions are equally important to a successful program. I feel it is important that I touch on one additional item included in the Senator's proposal. The bill allows for a modified certificate to be made available to families at 80% of median income. An alternative suggestion to limit rental assistance to families with incomes no more than 50% of median income would be a major program impediment. This restriction leaves a significant affordability gap where rents are to be established at HUD's modified certificate rent levels(See Schedule B). These lower income limits would cause displacement problems and result in limiting projects to these currently occupied by very low income households. These projects are likely to be more expensive to repair and require deeper subsidies, thereby reducing the number of units that could be rehabilitated.

In conclusion, I would like to urge your serious consideration and support for the bill proposed by the Senator from New York.

EXHIBIT A

Prototype Project Analysis, Using HUD Proposed 'Modified' Existing Section 8 Rents for New York City

1. HUD Proposed Rents

	1983
0-BR @	$257
1-BR @	312
2-BR @	367
3-BR @	422
4-BR @	477

Assume average apartment @ 3.75 rms/du and average rent per month @ $353

2. Financial Profile at market interest rate (17%) for 25 year term

Gross Rents	$4,236
5% Vacancy	212
Adjusted Gross Income	4,024
Estimated Expenses	2,200
Real Estate Taxes	350
Net Available	1,474

3. Estimated Value $8,664

4. Mortgage Financing without Insurance @75% loan to value

Mortgage ... $6,498

5. Mortgage Financing with FHA Insurance @ 90% of value

Mortgage ... $7,797

6. Mortgage Financing with Tax-Exempt Financing Rate Assumed @ 13%; 90% Loan to Value

Mortgage ... $9,908

Projects requiring more extensive rehabilitation than can be carried by the mortgage indicated would require a government subsidy for every dollar over this amount.

4/12/82

SCHEDULE B

Evaluation of HUD Proposed Income Limitations on Proposed Moderate Rehabilitation Program for Existing Housing for New York City

1. Income Limits

	80% Median	('82) 50% Median	('83) 50% Median-Estimated
1 person	$15,250	$9,500	$9,975
2 "	17,400	10,900	11,445
3 "	19,550	12,250	12,862
4 "	21,750	13,600	14,280
5 "	23,100	14,450	15,172
6 "	24,450	15,300	16,065
7 "	25,800	16,150	16,957
8 "	27,200	17,000	17,850

2. HUD Modified Certificate Rents for 1983

	Rent/mo.	Utilities	Total Rent Cost
0-BR	$257	$17	$274
1-BR	312	24	336
2-BR	367	31	398
3-BR	422	37	459
4-BR	477	45	522

3. Calculate Minimum Income* Required for a Family To Afford Total Rent Cost--Compare to 50% of Median

	Minimum Income	'83 @ 50% Median	Difference
0-BR	$10,960	$9,975	(985)
1-BR	13,440	9,975 to 11,445	(1,995 to 3,465)
2-BR	15,920	12,862 to 14,280	(1,640 to 3,058)
3-BR	18,360	14,280 to 15,172	(3,188 to 4,080)

* Affordability based on 30% of income test

4/12/82

STATEMENT OF MICHAEL LAPPIN, PRESIDENT, COMMUNITY PRESERVATION CORP.

Senator **Lugar**. Thank you, Mr. Zelikson.

Mr. Lappin.

Mr. **Lappin**. Thank you, Senator.

Mr. Chairman, I am Michael Lappin, president of New York City Community Perservation Corp., a nonprofit corporation created by 37 New York banks.

CPC's purpose has been first, to provide construction and permanent financing for the renovation of low- and moderate-income housing and second, to work with government to identify and rectify the regulatory impediments that conflict with the provision of such investments.

Since our beginning in 1974 we have committed $97 million to rehabilitation, which represents about 10,500 apartments renovated and over 270 buildings.

We currently produce about $20 million of renovated housing each year, or about 2,000 units a year.

On behalf of the board of directors, I would like to thank you for the opportunity to testify and support Senator D'Amato's proposed Multifamily Rehabilitation Act of 1982. The bill which is to be introduced is closely modeled after programs that have worked well in New York City.

I believe this bill can be made successful throughout the country.

Let me speak briefly on several points in the proposed legislation.

First, benefits are targeted to designated neighborhoods. The bill relies on local governments' designations of low-income neighborhoods which are experiencing deterioration, but in which housing stock is basically sound and abandonment is not pervasive.

Thus, it concentrates on viable, low-income neighborhoods where, without massive subsidies, decline can be arrested.

Second, the bill concentrates on moderate rehabilitation, not new construction or substantial renovation.

COST FOR REHABILITATION

CPC's average cost for rehabilitation that we financed this last year was $11,500 a unit. This included about $3,000 for refinancing and $8,500 for rehabilitiation or construction. These were multifamily projects built in the 1920's and 1930's. The construction focused upon replacing mechanical systems, plumbing, heating, wiring, elevators; weather tightening measures such as roof replacement, window replacements; and various cosmetic improvements.

These improvements, taken together, both prolonged project life and improved operational efficiency. The average rent for this level of financing—which often is performed with no Federal subsidy in the financing—was about $80 a room a month, or, for a one-bedroom apartment, approximately $250 a month. This is a cost—using a 4-to-1 income-to-rent ratio—affordable to families with annual incomes as low as $15,000.

The committee is well aware of the cost and the rents required to support substantial rehabilitation of new construction. It will readily appreciate the cost-effectiveness of early intervention to preserve existing housing resources.

Third, the Senator's proposal provides funds for rehabilitation, but it requires a leveraging for no less than an equal amount of private funds and thus stretches the Federal subsidy further.

The maximum loan feasible today in our low- and middle-income neighborhoods is $8,000 per apartment. This places severe limits on the kinds of buildings which can be rehabilitated.

The inability to rehabilitate the worst buildings in the neighborhood limits private investment in adjacent buildings. The bill extends the range of buildings that can be rehabilitated by mixing market rate funds with below market loans or grants of public funds. This is similar to an existing program, called the participation loan program, in New York city. Here loans are underwritten and subject to the discipline of private lenders, such as ourselves, Citibank, and other banks in the city.

The underwriting take place in conjunction with city loan officers responsible for designated neighborhoods.

Resultant blended interest rates relieve some of the burdens of extraordinary interest levels and make feasible larger loans that are necessary to renovate those buildings which have already slipped into severe disrepair. Under some circumstances, where market rents are about $100 per room per month, substantial rehabilitations can be undertaken.

Fourth, the Senator's proposal directs section 8 certificates. These rehabilitated buildings would have a priority for the certificates. Most rehabilitation loans we have made have required rent increases. Not every tenant in occupancy at the time of rehabilitation has been able to afford the increases. For some tenants, those with fixed incomes, the targeting of existing section 8 is crucial to support rehabilitation lending.

In the buildings we have financed over the past years, about 20 percent of the tenants in the buildings have been eligible for that subsidy.

ELIGIBILITY STANDARDS

The D'Amato bill maintains the eligibility standards for that rent subsidy at 80 percent of the median income for buildings undergoing rehab, this is opposed to the 50-percent standard proposed in the voucher program under which half the tenants now receiving subsidies in our buildings would be made ineligible. The potential displacement that would result from the voucher program's lower eligibility would render many of the rehabilitations infeasible. We would argue that the 80-percent standard should remain. It is reasonable on the basis not only that it supports housing for the holder of the certificate, but also that it helps leverage private investment in housing rehabilitation.

The cost of these combinations of programs, limited rental subsidies, plus the leveraging finance subsidies, is far less costly and many more times more efficient than previous housing production programs.

I direct your attention to a chart in my written testimony that compares the cost of these programs.

Important to the preservation efforts is the ability to raise adequate private mortgage money. In the past, mortgage finance, both short-term construction financing and long-term mortgages, was furnished by banks, savings and loans and similar institutions. These entities developed a sizable body of experience and expertise but are no longer able, alone, to meet the Nation's long-term mortgage needs.

SECONDARY MORTGAGES

Long-term financing must also be sought from pension funds and other similar institutions with portfolio needs for which long-term financing is appropriate. The traditional institutions can use their real estate mortgage expertise to originate mortgages, provide construction financing, construction management, and loan servicing. But a mechanism is needed to transfer such construction mortgages to the secondary markets.

The key to such sales to the secondary market is FHA coinsurance, which reduces investment risk and thereby meets the investment criteria of long-term mortgage investors.

The Senator's proposal includes an important modification to permit the entry of urban rehabilitation mortgages into the secondary market.

First, it modifies the appropriate vehicle, 223F insurance, to permit rehabilitation costs of up to $20,000 a unit, at levels sufficient to permit most rehabilitations.

Second, the proposal permits cash payouts of any insurance benefits, a measure important for mortgage sales to secondary purchasers.

Third, as previously mentioned, it proposes housing quality standards to meet the local codes, rather than HUD's minimum property standards. The latter are generally agreed to be too costly and if adhered to would have the effect of pricing rehabilitation out of most rental markets.

Once suitably fashioned, it is important that the FHA insurance can be cost effectively processed.

Section 244, the National Housing Act coinsurance program, was authorized with one major objective being the reduction of processing delays. It was intended to rely on the underwriting expertise and processing efficiency of private sector mortgage originators. A lender would assume a portion of any loss in case of default.

The Senator's proposal, tied to designated neighborhoods, would authorize the taking of the top 10 percent of insurable loss by the private originating lender with the remaining 90 percent of insurable loss taken by FHA in these designated areas.

The proposed coinsurance formula is well known to banks, as it is modeled after the Small Business Administration's guaranteed loan program, which I understand is heavily subscribed by a number of lenders in New York City.

Similarly, the originating lender could sell off the 90-percent portion to the secondary markets and keep the 10-percent uninsured portion for its own portfolio.

We believe the Senator's proposal establishes a mechanism and an insurance formula that would attract the large sums of money which are necessary to deal with the problems of neighborhood preservation.

Finally, the proposed act amends section 11(b) of the 1937 Housing Act to permit tax-exempt financing for buildings in the targeted area. This opens another important source of financing to assist in the preservation of urban neighborhoods.

The Multi-Family Rehabilitation Act of 1982 which Senator D'Amato is proposing can accomplish several goals.

One, provide for low-cost rehabilitation of urban neighborhoods' older multifamily housing at rents affordable to current residents, and two, minimize public moneys and bureaucracy in rehabilitation, three, maximize the use of both the resources and expertise of the private sector, and four, provide for the potential of tapping national credit markets for financing for these urban neighborhoods.

Thank you, Mr. Chairman.

[The complete statement follows:]

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Financing for Neighborhood Preservation

TESTIMONY OF

MICHAEL D. LAPPIN

PRESIDENT OF THE NEW YORK CITY
COMMUNITY PRESERVATION CORPORATION

BEFORE THE SENATE SUBCOMMITTEE
ON HOUSING AND URBAN AFFAIRS

APRIL 15, 1982

Mr. Chairman:

I am Michael Lappin, President of The New York City Community Preservation Corporation, a non-profit corporation created by 37 of New York's major commercial and savings banks. CPC's purpose has been, first, to provide construction and permanent financing for the renovation of low and moderate income housing in targeted urban neighborhoods and, second, to work with government to identify and rectify those regulatory and processing impediments which conflict with the provision of such private investment. Since our creation in 1974, we have committed over $97 million for rehabilitation. This sum represents 10,400 apartments and over 270 buildings. We currently produce approximately $20 million of renovated housing each year.

On behalf of our Board of Directors, I would like to thank you for the opportunity to testify in support of Senator D'Amato's proposed Multifamily Rehabilitation Act of 1982. While CPC has established a mechanism for private sector leadership in financing moderate rehabilitation, its continued success and replicability in other communities depends on an ability to gain access to the national capital markets. The Multifamily Rehabilitation Act provides essential tools to achieve this access.

Let me speak briefly on several important points in the proposed legislation. First, the targeting of benefits to designated neighborhoods. The proposal does not scatter its efforts among isolated buildings, selected or approved one-by-one by the federal government. Rather, it relies on local government's designations of low-income neighborhoods which are experiencing deterioration, but in which the housing stock is basically sound and abandonment is not pervasive. Thus, it concentrates on viable low-income neighborhoods where, without massive subsidies, decline can be arrested. Where this targeting approach was followed by CPC, we found another benefit: it multiplies the effect of each single renovated project. To remain competitive in the rental market with upgraded buildings, adjacent buildings often undertake their own program of improvements.

Second, the Senator's proposal concentrates on moderate rehabilitation, not new construction or substantial renovation. This is the key to cutting costs and thereby enabling the building to provide an additional 30 years or more of decent, safe housing. CPC's average cost for rehabilitation this past year was about $11,500 per unit. This included about $3,000 per unit for refinancing/acquisition and about $8,500 per unit for rehabilitation. The construction focused upon replacing mechanical systems -- plumbing, heating, wiring and elevators, weather tightening measures such as roof replacement, window replacements -- and cosmetic improvements. Taken together, these improvements both prolong a building's useful life as well as improve its operational efficiency. The average rent needed to support this financing this past year was about $80 a room a month, a cost affordable -- using a 4:1 income to rent ratio -- to families with annual incomes as low as $15,000. This Committee is well aware of the costs and rents required to support substantial rehabilitation and new construction, and will readily appreciate the cost effective approach of early intervention in preserving our housing resources, as proposed in this legislation.

Third, the Senator's proposal provides government funds for rehabilitation but requires a leveraging of no less than an equal amount of private funds. It therefore stretches federal housing assistance further.

Within today's economic constraints, the maximum loan CPC has been able to make using solely market rate funds in its low and middle income neighborhoods is about $8,000 per apartment. This places severe limits on the kind of buildings which can be rehabilitated. Indeed, the inability to rehabilitate the worst buildings in a neighborhood often inhibits private investment in adjacent buildings. The Multifamily Rehabilitation Bill, by providing grants, increases the monies that may go towards upgrading buildings, and thereby can deal with more severely deteriorated buildings and lower income families.

The City of New York has established a similar arrangement called the "Participation Loan Program" which, in conjunction with private financing, has spearheaded improvement in previously declining neighborhoods. In this Participation Loan Program, which is consistent with the Senator's proposal, loans are underwritten by, and subject to the discipline of, private lenders such as CPC, Citibank, Anchor Savings Bank, and others. This underwriting is done in conjunction with City loan officers responsible for designated neighborhoods. Private loans at market rates are combined with public funds at below market rates. The resulting blended interest rate relieves some of the burden of today's extraordinary interest levels and makes feasible the larger loans which often are necessary to renovate those buildings which have already slipped into severe disrepair. Indeed, under this method, buildings needing as much as $28,000 per unit in financing have been produced at market rents. These subsidies, in effect, have and can extend the range of possible rehabilitations to include most of the deteriorated buildings within the target neighborhoods. The program, therefore, permits public subsidies to be adjusted to the level of need and be furnished only to the extent necessary to make a project economically viable. The rest is left to private financing. This sound policy is encouraged by the Senator's proposal.

Fourth, the Senator's proposal directs Section 8 "Existing Housing" certificates directly to the tenants in rehabilitated buildings. While most rehabilitation loans require rent increases, not every tenant in occupancy at the time of rehabilitation is able to afford these increases. For these tenants, chiefly the elderly on fixed incomes, the targeting of the existing Section 8 rent subsidy or its successor program is crucial to support rehabilitation lending. In the buildings that CPC has financed, about 20% of the tenants have been eligible and required that subsidy. Targeting of subsidies is necessary to support loan underwriting and to avoid the displacement of tenants. The D'Amato bill maintains the eligibility standard for rent subsidy at 80% of the median income -- as opposed to the 50% standard proposed for the voucher program. If the lower standard were used, half the tenants now receiving subsidies in CPC buildings would be ineligible. The potential displacement that would result from lower eligibility would render many rehabilitation projects unfeasible. I would argue that the 80% eligibility standard is reasonable on the basis that it not only supports housing for the holder of the certificate, but also helps leverage investment in housing quality and neighborhood redevelopment.

The cost of these combinations of programs - limited rental subsidies plus leveraged financing subsidies - is far less costly and many times more efficient than previous housing production programs. The attached chart summarizes CPC's experience in programs similar to the one proposed.

The D'Amato proposal for co-insurance is potentially the most productive vehicle for financing rehabilitation efforts. In the past, mortgage financing -- both short term construction financing and long term mortgages -- was furnished largely by banks, savings and loans, and other similar institutions.

These entities developed a sizable body of experience and expertise, but are no longer able to meet the nation's long term mortgage needs. Long term financing must also be sought from pension funds and similar institutions with portfolio needs to which long term financing is appropriate. The traditional institutions -- banks and so forth -- can continue to use their real estate and mortgage expertise: they can originate mortgages and provide the short term financing, limited long term financing, and loan servicing. However, a mechanism is needed to transfer short term mortgages to pension funds and the like when long term financing is needed. This mechanism, the secondary mortgage market, exists and relies heavily on FHA mortgage insurance to facilitate mortgage transfers by reducing investment risk and thereby meet the investment criteria of long term mortgage investors. The Senator's proposal includes important modifications to permit, for the first time on any significant scale, the entry of urban rehabilitation mortgages into the secondary market.

First, it modifies the appropriate vehicle, FHA 223(f) insurance, to permit rehabilitation costs of up to $20,000 per unit, a level sufficient to permit most moderate rehabilitation. The current level -- $3,000 -- was intended to cover only minor repairs performed in conjunction with an owner's refinancing of existing indebtedness. It is inadequate for the majority of deteriorated buildings in urban neighborhoods. Second, the proposal permits cash payout of any insurance benefits, a measure facilitating mortgage sales to secondary purchasers. Third, it proposes housing quality standards to meet local codes rather than HUD's minimum property standards. The latter are generally agreed to be too costly and would have the effect of pricing rehabilitation out of most rental markets.

Congress and the FHA have long recognized that, in some sectors of the real estate market, traditional FHA processing is too cumbersome, expensive, and time consuming. In Section 244 of the National Housing Act, a co-insurance program was authorized with one major objective being the reduction of processing delays. It was intended to rely on the underwriting expertise and processing efficiency of approved private sector mortgage originators. In exchange, a lender would assume a portion of any loss in case of default. Under co-insurance as presently established, this loss is approximately 20% of the mortgage debt. While the risk of such an uninsured loss may be a good trade-off for processing speed in the case of lenders in less risky real estate markets, it has proven insufficient for the more difficult and risky financing of low income urban housing rehabilitation.

The Senator's proposal would authorize a risk sharing of 10% by a private lender and 90% by FHA. This insurance formula is carefully confined to the deteriorating urban neighborhoods and to the renovation projects where it is essential. The formula is restricted to 223(f) insurance given to low income projects in the target neighborhoods with which, as I mentioned earlier, the Senator's proposal is chiefly concerned.

The proposed co-insurance formula -- first 10% of loss taken by underwriter, the remaining loss taken by FHA -- is well known to banks as it is modeled after the Small Business Administration's guaranteed loan program (Section 7(a) of the Small Business Act of 1958). Similar to that program, the originating lender might seek to sell off the 90% insured portion, keep the 10% uninsured portion, and provide servicing and supervision of the project. In addition, the bill allows the lender to seek additional mortgage insurance for that 10% portion of the loan at risk. This will provide an additional incentive for localities to create such insurance funds to encourage rehabilitation financing in the most high risk situations.

Under the co-insurance amendments I have just described, an originating lender would be able to process and obtain FHA 223(f) insurance within the same time interval in which he was performing his loan underwriting. With FHA insurance thereby committed, the originating lender could begin construction and provide the short term financing for it, confident that upon completion the insured long term mortgage would be saleable on the secondary market.

The renovation of America's aging urban neighborhoods requires vast sums of investment capital, sums for which the resources of pension funds and others of today's long term lenders alone appear adequate. Rehabilitation investment in moderate rehabilitation now will eliminate the far more costly need for new construction or substantial rehabilitation in the future. The Senator's proposal establishes a mechanism and an insurance formula which would facilitate this necessary flow of long term mortgage investment.

Finally, the proposed Act amends Section 11(b) of the 1937 Housing Act to permit tax exempt financing for buildings in the target areas. This opens another important source of financing to assist in the preservation of our urban neighborhoods.

In sum, the Multifamily Rehabilitation Act of 1982 can accomplish several goals:

1. Provide for the low cost rehabilitation of urban neighborhoods' older multifamily housing at rents affordable to current residents;

2. Minimize public monies and bureaucracy in the rehabilitation process;

3. Maximize use of both the resources and expertise of the private sector to undertake housing rehabilitation;

4. Provide for the potential of tapping the national credit markets for financing for these urban neighborhoods.

Thank you, Mr. Chairman. It has been an honor to speak before this Committee.

COMPARISON OF SUBSIDY PROGRAMS FOR MULTIFAMILY HOUSING REHABILITATION

PROGRAM	TOTAL MORTGAGE FINANCING PER UNIT	PRIVATE FINANCING PER UNIT	BUILDING WIDE FINANCING SUBSIDIES	INDIVIDUAL RENT SUBSIDIES			COST TO GOVERNMENT OF SUBSIDIES PER UNIT	
			SUBSIDIZED PUBLIC FINANCING PER UNIT	% OF UNITS ON RENT SUBSIDIES	COST OF SUBSIDY PER UNIT / YEAR	TERM OF SUBSIDY	BUILDING WIDE FINANCING SUBSIDY (9)	INDIVIDUAL RENT SUBSIDY (10)
CPC								
CPC MODERATE (1) REHABILITATION -Tenants in place	$ 8,900	$8,900	$ 0	20	$1,500 (7)	5	$ 0	$1,086
CPC-CD MODERATE (2) REHABILITATION -Tenants in place	14,600	6,200	8,400 (5)	20	$1,500 (7)	5	6,364	1,086
CPC-CD SUBSTANTIAL(3) REHABILITATION -Vacant buildings	27,000	10,400	16,600 (5)	0	0	0	12,377	0
SECTION 8 SUBSTANTIAL REHABILITATION								
- Vacant Building (4)	55,000	0	55,000 (6)	100	10,000 (8)	20	26,119	69,020

- - - - - - - -

(1) Data based on 16 CPC construction loans closed between 9-1-80 through 8-31-81

(2) Data based on 16 CPC construction loans with participation interests of Community Development funds in permanent financing closed between 9-1-80 through 8-31-81

(3) Data based on 4 CPC construction loans with participation interests of Community Development funds in permanent financing closed between 6-28-79 through 8-31-81, adjusted for inflation. These buildings were located in neighborhoods which could support a market rent of about $95 a room a month, and, hence, required no rental subsidies.

(4) Estimates made by City housing officials for 1981.

(5) Money is Community Development funds lent by City at 1% interest typically over a 30 year term.

(6) GNMA tandem plan funds at 7½% typically for 40 year term.

(7) Existing Section 8 subsidy on 5 year contract directed on priority basis to tenants who live in CPC financed buildings at construction start. Subsidy paid directly to owners.

(8) Substantial Section 8 rent subsidy typically for 20 years.

(9) Cost based on discount that government would pay if mortgages were sold. Discount assumes 1981 GNMA mortgage yields of 15%. GNMA and CD loans are assumed to be self-liquidating with level monthly payments through term of loan.

(10) Present value of subsidies taken assuming discount rate of 13.5%, the approximate 6 month Treasury Bill rate for 1981. Rent subsidy payments assume same monthly payment for term of contract.

Senator **Lugar**. Thank you. We are indebted to Senator D'Amato for coming forth with this bill.

Senator D'**Amato**. Thank you for your gracious remarks. And let me extend to both Mr. Lappin and Zelikson, my personal thanks, not only for their coming here today to testify on behalf of these proposals for moderate rehabilitation, but for their tireless efforts in helping to draft and frame in consultation with numerous local authorities both in the private and in the public sector to attempt to develop the legislation that will apply FHA 223(f) insurance to, moderate rehabilitation to make it more applicable. And both Mr. Lappin and Zelikson have had broad backgrounds and tremendous experience in this area on the municipal side and in the private sector and have done much to afford the city of New York, in particular, a tremendous uplift.

INCREASE VOUCHER LIMIT

There seems to be, and Mr. Lappin touched on it, I think one of the areas that may have a great deal of difficulty convincing some of my colleagues in terms of the necessity for raising the voucher limit from 50 percent of the median income to 80 percent to make it an effective program. How do we counter the arguments that 80 percent, that is a program for the wealthy or for those who are not in need? It does not address the programs or the priorities of providing housing opportunities for those who are without.

This is a frequent argument put forth against reestablishing the limit at 80 percent. It has been moved down to 50 percent. Mr. Lappin, I think it is key, I think it is crucial that we be able to answer this question.

Mr. **Lappin**. The designated neighborhoods are mixed income neighborhoods, and any building, any of the 270 buildings that we have renovated, the incomes are from the very low income to working class families: from $8,000 to about $30,000. On the practical side, if you cannot take care of the existing tenants there, your renovation efforts will result in substantial displacements. In our experience, lowering the eligibility standard for assistance from 80 percent of median income to 50 percent of median income might result in having to displace up to 10 percent of the tenants in each building for which we provide financing. In a practical level, very few lenders will want to get into that situation and the resultant disruption where the higher rents will cause that kind of displacement. If you cannot take care of the existing tenants there, which is a mix, you are not going to take care of any of those tenants.

Mr. **Zelikson**. If I might expand on that, in terms of using specific numbers, using the HUD-proposed voucher rents for 1983 for New York. Let's focus on a three-bedroom apartment. The proposed rent, $422, plus $37 for utility allowance, would give you $459 rental cost to a family. If you were to take that same number and multiply it by 12 to give you an annual rent, then divide by the 30-percent rent income ratio for the HUD program, you would find that in order to carry the new rent the three-bedroom apartment would require minimum income of $18,360. Yet the HUD 50 percent of median income for a family that would be eligible to live in that unit, depending on family size, would range from $14,280 to

$15,172, leaving an income gap of $3,188 to $4,080. Basically what would happen if you were to propose—and again, this is a very modest rehab at these rents—to implement these rents, and you would find that everybody with an income that was in excess of $14,000 but below the $18,000 would have to pay a proportion of their income for rent well in excess of the 30-percent estimate. As a matter of fact, it starts to approach 40 percent in most categories.

The bottom line is that you would not be able to go ahead with that project.

Senator D'AMATO. We are saying that if we adhere to a 50 percent figure, we're going to continue to lose housing. Is that what we are really saying?

Mr. ZELIKSON. In my opinion, yes, or you will have to limit your program to those buildings that are currently occupied by virtually 100 percent very low income tenants. You have the interesting situation then of probably looking at a building that is in more disrepair and will be much more extensive to rehabilitate and require a deeper level of subsidy, so that the numbers being projected by HUD, for instance, and the number of projects that might be treated with their subsidy, would be reduced accordingly.

Senator D'AMATO. We have another phenomena in terms grouping old people with lower incomes in the same building, then.

Mr. ZELIKSON. It is a process that is not going to work. It's not going to deal with existing housing. One of the major advantages of the program is that you do not have to create the segregation that exists in any other housing.

Senator D'AMATO. Then it would maintain segregation if you leave it at the 50-percent level.

Mr. ZELIKSON. It would reinforce it.

FHA-INSURED MORTGAGE

Senator D'AMATO. Should owners who have obtained FHA insurance be personally liable for their mortgage?

Mr. LAPPIN. I understand that FHA—there has been some talk within FHA to require a personal liability on any FHA-insured mortgage. This may be fine for owner-occupied structures, but in large multifamily properties, particularly low-income areas, that practice is virtually unknown. It is unknown, because in the multifamilies in New York City, it is an unreasonable risk for owners to put up personal resources as collateral in addition to the building, in addition to his time, in addition to his money for rehabilitation.

Also, if there is personal recourse, it would be impossible to sell tax losses and, thus, use the depreciation benefits of the Economic Recovery Tax Act of 1981. Hence, you deny the benefits of that act for low-income housing, if you have that recourse requirement. It is almost the unanimous opinion among lenders in New York City that if there is a personal recourse in FHA, it would be virtually impossible to do any of this kind of multifamily housing anywhere in New York and most think anywhere in the country.

Senator D'AMATO. There has been a claim made by some in terms of reacting to the coinsurance provisions that we have offered in this new legislation that the banks would use it to bail out their bad loans. How would you respond to that?

Mr. **Lappin**. I think the banks that have buildings in these designated areas, have very few in their present condition that meet the construction and the quality standards, of the FHA 223(f) program. And in order to bring it up to those standards, they will have to make considerable additional investment and spend their time to upgrade these buildings. So they will not be able to get out of them unless they make the improvements. Second, if there are low-yielding mortgages on the property, the FHA insurance looks into that, and there has to be proper discounting before the mortgage can be insured.

I do not think unless the bank has an extremely good property in the low-income neighborhoods, I do not see any real serious possibility of this.

Senator D'**Amato**. Mr. Chairman, one other question, if I might.

TAP DEMONSTRATION PROGRAM

A great program was the TAP demonstration program that this committee helped and Secretary Pierce made available that opportunity to certain communities in New York, in particular, has shown, I believe, what can be done with, relatively speaking, small sums of money. I'm wondering if you would care to comment on the types of buildings, the types of apartments, the sizes, the quality, compare the results of what took place under that demonstration program, in terms of comparison of the usual HUD development program. I do not mean to be discouraging, but I think if we can look at the differences and then describe basically the typical TAP building, what it is like, and if you could, also comment on the mortgages and the subsidy involved, so that we can get a relative comparison in terms, again, of what the usual HUD development program has been, what the costs have been, what the subsidy has been, and what our final product, or what the final product in the TAP was.

Mr. **Zelikson**. If I might. The New York TAP demonstration involved some 28 buildings with a total of 1,504 units. There were some $15 million of GNMA tandem money made available, but not at a 7½ percent rate. It was at blended rate, depending on the rate of refinancing that was attached to a building. I was personally involved with the processing through HUD of nine of those buildings with 327 units involving $4.3 million worth of GNMA financing.

Some months ago I was asked by the HUD regional administrator whom I have been associated with for some number of years, if I would give him an analysis of the projects that I was working on, and I did. It was rather interesting. First of all, keeping in mind that all of the rents that were set on these buildings did not include any subsidies beyond those that were attached to the financing, the average rent on a typical unit was well below the current HUD fair market rents for existing housing, so it was very much a market-rent type of situation within that neighborhood. The apartments themselves were 20 to 30 percent larger in gross floor area than the typical FHA-insured project. That was information that I worked out with some of the HUD area office architectural people. Two-thirds of the units, again, the ones that I was involved with, had two or more bedrooms and were suitable for family use. A better distribution, I might add, than the typical HUD profile in some of their development programs. In fact, the average GNMA mortgage for this group of projects was $13,300 with a range of about $5,500 to about $20,000 at the up end, where there were some rather extensive rehabilitations. By HUD's own calculations, the average replacement cost, instead of being $13,000, was estimated at $58,000 per unit, a considerable saving, and very cost-effective approach, I think, to this type of housing.

I did some further calculations in terms of what the direct and indirect subsidy costs would be, including taking the present value of the GNMA subsidy and calculated it to be less than $10,000 a unit in Government subsidy for a program that produced this kind of housing. I went further and estimated the cost under a section 8-type program and found a number that approached $70 million, and I thought that was a very interesting comparison and, in fact——

Senator D'AMATO. $70,000?

Mr. ZELIKSON. Excuse me, $70 million—excuse me.

Senator D'AMATO. $10,000 subsidy per unit?

Mr. ZELIKSON. What I did was multiply the subsidy per unit by the number of units involved and found some $3.5 million worth of present value subsidy for this group of projects. If one were to use an alternate program, it would involve something approaching $70 million in Government subsidies.

Senator D'AMATO. $3.5 million compared to $70 million?

Mr. ZELIKSON. Exactly.

Senator D'AMATO. I just wanted to let you know we were listening.

Senator LUGAR. Thank you very much, Senator D'Amato, and many thanks to you on the panel for illuminating the details of this proposal and for your forthcoming responses to the Senator's questions. We appreciate your coming.

Mr. LAPPIN. Thank you.

Mr. ZELIKSON. Thank you.

Senator LUGAR. The Chair would call upon our final panel.

STATEMENT OF CUSHING N. DOLBEARE, PRESIDENT, NATIONAL LOW INCOME HOUSING COALITION

Senator LUGAR. We are deeply grateful to you for your patience. Ms. Dolbeare has been here since the opening gun. At this point, however, please summarize your testimony. You have heard others who have summarized, some have not summarized as succinctly as might be desirable. The Chair will not impose unreasonable limitations, that you at least can make certain that your points are heard, and obviously, your statements will be made a part of the record. And then we will proceed to questioning after that.

Ms. Dolbeare.

Ms. DOLBEARE. Thank you, Senator. I would like, if I may, not only to submit my statement for the record, but to add some additional material which relates to the topics that we are discussing this morning.

Senator LUGAR. We are happy to include it in the record.

[The complete statement follows:]

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Hon. Edward W. Brooke, *Chairperson* Cushing N. Dolbeare, *President*

MAINTAINING AND EXPANDING LOW INCOME HOUSING ASSISTANCE

Statement of Cushing N. Dolbeare, President, National Low Income Housing Coalition, before Subcommittee on Housing, Committee on Banking, Housing, and Urban Affairs, United States Senate, April 15, 1982.

In these times of budget constraints and deepening housing crisis, the National Low Income Housing Coalition urges a renewed commitment to giving top priority, in federal housing programs, to meeting the housing needs of low income people.

Rather than reciting, yet again, the facts on low income housing needs and the impact of the Administration's proposed cuts in low income housing programs, I have appended to this relatively brief statement the material which in one form or another I have presented this spring before the Senate Agriculture Committee, the Housing Budget Committee, and the House Housing Subcommittee. This statement will focus on the Administration's proposed bill, bills introduced by Senators Dodd and Tsongas, and other specific approaches relevant to this Committee's deliberations.

Before doing so, however, three points on housing need and housing commitments should be made, to set the context:

> The President's Commission on Housing has estimated that slightly over half of the twenty million households with incomes below 50% of median are renters, and that only one out of four of these poor renter households now receives housing assistance.
>
> In 1970, a family with an income of $3,000 who paid the median rent of $85 spent 34% of its income for shelter, and had $165 monthly left over for all other needs. There were then 5.8 million renter households with incomes below $3000. In 1980, a family with an income of $3,000 who paid the median rent of $179 spent 72% of its income for shelter and had only $71 left over for all other needs. Ten percent of all renters, or 2.7 million households, still had incomes below $3000 in 1980.
>
> While low income housing assistance programs have been cut back, tax expenditures for housing have been unconstrained. In 1981, the INCREASED COST of housing-related tax expenditures ($7.6 billion) was considerably HIGHER THAN HUD'S OUTLAYS FOR LOW

INCOME HOUSING assistance ($5.7 billion in housing payments and $1.1 billion for public housing operating subsidies). Moreover, the TOTAL COST of housing-related tax expenditures ($33.3 billion) was slightly MORE THAN THE CUMULATIVE HOUSING PAYMENTS MADE BY HUD AND ALL OF ITS PREDECESSORS, SINCE 1937. Moreover, if the rate of increase for the homeowner mortgage interest deduction anticipated for the 1983-87 by the Joint Committee on Taxation is projected for the rest of this century, its total cost would be over two trillion dollars, almost ten times the amount of outstanding subsidized housing commitments.

Against this backdrop, the National Low Income Housing Coalition urges that four basic principles guide housing legislation this year:

> First, we must maintain our present low income housing inventory in viable condition, without rent increases. This means rejecting the proposals to count food stamps as income and to raise the limit on rent increase resulting from program changes to 20% per year. It also means providing adequate troubled projects and operating subsidies to cover the difference between tenant contributions and the cost of operating decent housing. Finally, it means prohibiting arbitrary limits on subsidy amounts which will force projects into default or abandonment.
>
> Second, we should not retreat from present commitments. The pipeline should be built, not truncated. All funds recovered because commitments turn out not to be feasible should be reprogrammed, not rescinded.
>
> Third, we need to maintain and expand housing production, through both rehabilitation and new construction, for low income people. We urge continued provision of funds for the public housing, 202 housing for elderly or handicapped, and Farmers Home Section 515 programs, as well as the exploration of new approaches.
>
> Fourth, we need to maintain the rural housing programs of the Farmers Home Administration at an adequate level. We support funding the rental assistance, home ownership, farm labor housing, self-help housing, and the water and sewer programs which are required for development in rural areas at no less than their 1982 levels. We oppose proposals to abandon these programs in favor of a block grant.

SPECIFIC RECOMMENDATIONS

THE "MODIFIED SECTION 8 EXISTING HOUSING" PROPOSAL SHOULD NOT BE ADOPTED.

The effect of the proposed modifications would be to reduce the amount of housing assistance by 15-20%. Tenants would have to pay the extra costs out of their own pockets. It would be even harder for large households to find quarters.

This would be done by reducing the payment standard on which the amount of the voucher would be calculated to about 80-85% of present

delete this out

Section 8 Existing Fair Market Rent levels. Tenants would then negotiate their own rents, paying less if they could find a place for less; paying the extra if they couldn't.

As proposed by the Administration, this constitutes a hidden rent increase for tenants being switched to the new program. I have queried a broad range of Section 8 housing administrators on whether their clients could find housing in their communities at 80% of current fair market rents. Not one thought it would be possible.

There is no provision in this new voucher program to provide annual adjustments for rent increases. This means further annual rent increases, unrelated to ability to pay, unless there is a major change from recent experience which is that operating costs have increased at roughly twice the rate of increase in tenant incomes.

Moreover, since expiring Section 8 existing contracts are to be converted to the new program, major rent increases for the households affected appear inevitable. If they continue in their present quarters, landlords are unlikely to reduce their rents because their subsidy is lower. If they look elsewhere, they face very tight rental markets.

The National Low Income Housing Coalition has consistently been concerned with housing affordability as a basic component of the low income housing problem and we have just as consistently supported efforts to use the existing stock of housing and to provide low income households with the same kinds of housing choices that are available to others.

However, there is clear evidence, both from the Experimental Housing Allowance Program and the Section 8 existing program, that vouchers prmarily serve households whose housing problem is limited to affordability. They do not provide shelter for households the private market is unwilling or unable to serve: large families, single-parent families, minority families. Even at present fair market rents, half of all households receiving Section 8 certificates are unable to find units within their alloted time period of sixty days. The proportion is far higher for minorities, female-headed households, and households now living in substandard housing.

Members of the President's Commission on Housing were given the following information on the proportions of Section 8 Existing voucher holders who failed to find housing within 60 days:

Household Type	Minority	Nonminority
1 person elderly	50%	42%
1 person nonelderly	54%	51%
Elderly couples	66%	50%
Younger couples	67%	45%

Household Type	Minority	Nonminority
1 parent, 1-3 children	75%	56%
1 parent, 4+ children	78%	76%
2 parents, 1-3 children	60%	57%
2 parents, 4+ children	72%	75%
All household types	72%	52%

We have no doubt that agencies allocated vouchers under the new proposal will be able to find families that will take them and use them. But it seems equally likely that few of these families will be among those who most desperately need help.

FOOD STAMPS SHOULD NOT BE COUNTED AS INCOME IN DETERMINING TENANT RENTS.

Our analysis of the rent increases proposed by the Administration this year is that they are far higher than the effect of raising tenant contributions from 25% to 30% of income. Moreover, they have their greatest impact on the very poorest households.

To illustrate this point, we have compared the impact of the rent increase adopted last year, when fully phased in, with the impact of counting food stamps as income, when fully phased in, for an unemployed mother on welfare with two children in each of the thirteen states represented by Senators serving on the Banking Committee.

> Last year's full rent increase is 20%, phased in over five years. The increase this year is 4%, substantially below the 10% cap on rent increases because of program changes (rather than income changes) adopted last year. Rents at 25% of income range from a high of $114.00 in California (where welfare grant is $506) to a low of $17.70 in Texas, where the welfare grant is only $118 (and the rent is 15% of gross income which is higher than 25% of adjusted income). The family in California had an average of $13.06 in cash left after paying rent, plus food stamps worth $2.43. The family in Texas had only $3.34 per day, plus food stamps worth $6.10.
>
> The rent increase from 25% to 26% of income, scheduled for this year, will not affect the family in Texas, which still pays 15% of gross income. A Texas family moving into HUD-subsidized housing would pay $20.40 in rent, leaving an average of $3.25 in cash each day, plus $6.10 in food stamps. The California family will have a 4% rent increase this year and, ultimately, a 20% rent increase when it pays 30% of income.
>
> If food stamps are counted as income, the California family would sustain a 16% rent increase, while the Texas family would, when fully phased in, have a 325% increase (paying 30% of income, counting food stamps). The family would then have only $1.42 left each day, plus $6.10 in food stamps, after paying its rent of $75.30.

In absolute terms, the low income family in California would pay $44.70 more in rent after the increase from 25% of cash income to 30% of cash-plus-foodstamps. The very much poorer family in Texas would pay $57.60 more.

So, the proposed change by counting food stamps as income would place the highest absolute and relative burdens on those least able to carry them.

THE PRESENT 10% CAP ON RENT INCREASES RESULTING FROM PROGRAM CHANGES SHOULD BE RETAINED, NOT RAISED TO 20%.

The National Low Income Housing Coalition, and others, have long contended that subsidized housing residents in fact often pay far more than 25% of their incomes for rent, because of the inadequacy of utility allowances. Now the Bureau of the Census confirms this view. Annual Housing Survey data show that 16% of the households living in subsidized housing paid more than 50% of their incomes for shelter, and one quarter paid more than one-third of their incomes.

It was at least in part in order to protect these families, who are generally the poorest, that Congress last year enacted a 10% cap on annual rent increases as a result of program changes. The Administration's proposal that this cap be increased to 20% should be rejected.

Again, the impact of the change falls most heavily on very poor people, who will have the biggest rent increases if and when regulations to prohibit "negative rents" for very poor families paying their own utilities and to drop the exclusion of extraordinary medical expenses from income are promulgated.

The following table shows the impact of this change, again basing the estimates on welfare and food stamp grants in each state for an unemployed welfare mother with two children.

State	Present rent at 25%	Rent if foodstamps counted	1984 rent with		Cash remaining	
			10% cap	20% cap	10% cap	20% cap
CA	$114.00	$132.25	$132.25*	$132.25*	$373.75	$373.75
CO	65.25	98.50	79.55	94.68	233.45	218.32
IL	63.00	96.50	76.23	90.71	225.77	211.29
IN	51.25	88.50	62.00	73.80	193.00	181.20
MD	55.00	91.00	66.55	79.20	203.45	190.80
MI	86.25	113.00	104.35	124.20	290.65	270.80
NM	49.50	87.25	59.89	71.28	188.11	176.72
NY	93.50	118.00	113.13	134.63	310.87	289.37
PA	67.00	99.50	81.06	96.48	236.94	221.52
RI	100.75	123.00	121.90	123.00*	331.10	330.00
TX	17.70**	62.75	21.41	25.48	96.59	92.52
UT	79.25	108.00	95.88	114.11	271.12	252.89
WI	105.75	126.50	126.50*	126.50*	346.50*	346.50*

EFFECT OF COUNTING FOOD STAMPS AS INCOME ON RENTS OF UNEMPLOYED MOTHER WITH TWO CHILDREN ON AFDC, SELECTED STATES, 1982 WELFARE AND FOOD STAMP GRANT LEVELS.

	WELFARE GRANT ONLY			WELFARE AND FOOD STAMPS		
	25%	26%	30%	25%	26%	30%
CALIFORNIA	114	118.56	136.8	132.25	137.54	158.7
% CHANGE	0	4	20	16	20.6	39.2
COLORADO	65.75	68.38	78.9	98.5	102.44	118.2
% CHANGE	0	4	20	49.8	55.8	79.7
ILLINOIS	63	65.52	75.6	96.5	100.36	115.8
% CHANGE	0	4	20	53.1	59.3	83.8
INDIANA	51.25	53.3	61.5	88.5	92.04	106.2
% CHANGE	0	4	20	72.6	79.5	107.2
MARYLAND	55	57.2	66	91	94.64	109.2
% CHANGE	0	4	20	65.4	72	98.5
MICHIGAN	86.25	89.7	103.5	113	117.52	135.6
% CHANGE	0	4	20	31	36.2	57.2
NEW MEXICO	49.5	51.48	59.4	87.25	90.74	104.7
% CHANGE	0	4	20	76.2	83.3	111.5
NEW YORK	93.5	97.24	112.2	118	122.72	141.6
% CHANGE	0	4	20	26.2	31.2	51.4
PENNSYLVANIA	67	69.68	80.4	99.5	103.48	119.4
% CHANGE	0	4	20	48.5	54.4	78.2
RHODE ISLAND	100.75	104.78	120.9	123	127.92	147.6
% CHANGE	0	4	20	22	26.9	46.5
TEXAS	17.7	17.7	20.4	62.75	65.26	75.3
% CHANGE	0	-.099999994	15.2	254.5	268.7	325.4
UTAH	79.25	82.42	95.1	108	112.32	129.6
% CHANGE	0	4	20	36.2	41.7	63.5
WISCONSIN	105.75	109.98	126.9	126.5	131.56	151.8
% CHANGE	0	4	20	19.6	24.4	43.5

EFFECT OF COUNTING FOOD STAMPS AS INCOME ON RENTS OF UNEMPLOYED MOTHER WITH TWO CHILDREN ON AFDC, SELECTED STATES, 1982 WELFARE AND FOOD STAMP GRANT LEVELS.

		WELFARE GRANT ONLY			WELFARE AND FOOD STAMPS		
		25%	26%	30%	25%	26%	30%
CALIFORNIA	RENT	114	118.56	136.8	132.25	137.54	158.7
	DAILY CASH LEFT	13.06	12.91	12.3	12.45	12.28	11.57
COLORADO	RENT	65.75	68.38	78.9	98.5	102.44	118.2
	DAILY CASH LEFT	8.24	8.15	7.8	7.15	7.01	6.49
ILLINOIS	RENT	63	65.52	75.6	96.5	100.36	115.8
	DAILY CASH LEFT	7.96	7.88	7.54	6.85	6.72	6.2
INDIANA	RENT	51.25	53.3	61.5	88.5	92.04	106.2
	DAILY CASH LEFT	6.79	6.72	6.45	5.55	5.43	4.96
MARYLAND	RENT	55	57.2	66	91	94.64	109.2
	DAILY CASH LEFT	7.16	7.09	6.8	5.96	5.84	5.36
MICHIGAN	RENT	86.25	89.7	103.5	113	117.52	135.6
	DAILY CASH LEFT	10.29	10.17	9.71	9.4	9.24	8.64
NEW MEXICO	RENT	49.5	51.48	59.4	87.25	90.74	104.7
	DAILY CASH LEFT	6.61	6.55	6.28	5.35	5.24	4.77
NEW YORK	RENT	93.5	97.24	112.2	118	122.72	141.6
	DAILY CASH LEFT	11.01	10.89	10.39	10.2	10.04	9.41
PENNSYLVANIA	RENT	67	69.68	80.4	99.5	103.48	119.4
	DAILY CASH LEFT	8.36	8.27	7.92	7.28	7.15	6.62
RHODE ISLAND	RENT	100.75	104.78	120.9	123	127.92	147.6
	DAILY CASH LEFT	11.74	11.6	11.07	11	10.83	10.18
TEXAS	RENT	17.7	17.7	20.4	62.75	65.26	75.3
	DAILY CASH LEFT	3.34	3.34	3.25	1.84	1.75	1.42
UTAH	RENT	79.25	82.42	95.1	108	112.32	129.6
	DAILY CASH LEFT	9.59	9.48	9.06	8.63	8.48	7.91
WISCONSIN	RENT	105.75	109.98	126.9	126.5	131.56	151.8
	DAILY CASH LEFT	12.24	12.1	11.53	11.55	11.38	10.7

[* Based on food stamp rent, not cap, which would be higher. ** 15% of gross income.]

One thing is apparent from the foregoing table: even though logic tells us that the differences between the 10% cap and the 20% cap should be widest for people with higher cash incomes and therefore higher rents, this is not the case because they have lower rent increases. (The same analysis would hold in connection with eliminating negative rents: only the very lowest income families receive them. Not-so-low income families would be unaffected.)

HUD SHOULD BE REQUIRED TO TAKE MAJOR MEDICAL EXPENSES INTO ACCOUNT IN DETERMINING TENANT RENTS.

Last year, HUD was given broad discretion to define "income" for purposes of determining rents in subsidized housing. A provision adopted in 1974 for Section 8 (and earlier for public housing) provided for exclusion of extraordinary medical or other expenses and for charging a lower rent to households with exceptional expenses.

With some exceptions, the elimination of medical deductions will fall most heavily on elderly and handicapped people, who do not have the resources to pay for major rent increases and cannot reasonably be expected to obtain them.

We urge either legislation or strong report language aimed at precluding these rent increases.

THE PRESENT RESTRICTIONS IN THE LAW ON DEMOLITION OF PUBLIC HOUSING AND DISPOSITION OF HUD-OWNED OR HUD-HELD MULTIFAMILY PROPERTIES SHOULD NOT BE REMOVED.

Although HUD and its predecessors have been subsidizing the provision of low income housing for 45 years, the current inventory stands at less than 3.5 million units -- an average of less than a million each decade. The private sector adds more units to the stock annually, even in a terrible year, than this per-decade average.

Moreover, low income housing projects were all -- even the recent ones -- built when costs were lower than they are today. Most were built at far less cost than we are ever likely to see again. And, at least in the case of public housing, the federal obligation to pay off the bonds remains, even if the project is destroyed.

The National Low Income Housing Coalition urges that high priority be given to retaining the present stock of assisted housing in viable condition, for low income occupancy. And, where projects need comprehensive modernization, these funds should be provided together with needed operating subsidies.

Current restrictions on the demolition of public housing make sense: demolition may only be undertaken if (1) units will be replaced in a "timely" fashion; (2) total cost of replacement is less than total cost of rehabilitation; and (3) displaced families will get decent, safe, sanitary, and affordable housing.

The Administration bill would repeal these standards, substituting looser ones. Demolition would become an eligible modernization activity, with several critical requirements waived. Projects, for example, could be slated for demolition without consultation with either local officials or tenants and without the same standards for assessing physical condition and the cost of improvements needed that apply to the modernization program.

The Coalition appreciates the concern which members of this Committee have for the viability of the public housing program and we have discussed possible remedies and approaches with the committee staff on a number of occasions. We hope to continue this process. What is needed, we believe, is not revision of the demolition section -- or any approach which would reduce the number of public housing units -- but rather a careful examination of the remedies which are needed to deal with the problems of a rather limited number of housing projects.

Finally, we would note that the President's Commission on Housing gave serious consideration to, in effect, abandoning the public housing and disposing of current projects. It found, however, that public housing provides shelter for hundreds of thousands of households that the private sector has been unwilling or unable to house decently and would not house even under a voucher program, that it is less expensive than providing vouchers to the same households, and that the federal government should retain control over income and rent levels as basic to maintaining the public purpose of the program, even as it relaxes other restrictions.

The arguments for opposing the proposed changes with regard to multi-family property disposition are similar. They rest on the foolishness of seeking on the one hand to find the funds needed to provide shelter to very low income people and, on the other hand, permitting projects which were built or used for this purpose to slip out of the inventory.

The critical decision to be made in property disposition is NOT what will bring the highest short-term return, but what is the most cost-effective method of providing shelter for low income people. The present law takes these long-range considerations into account. We urge that it be retained.

ADEQUATE OPERATING AND TROUBLED PROJECTS SUBSIDIES SHOULD BE PROVIDED FOR SUBSIDIZED HOUSING.

We urge authorization of $1.6 billion for public housing operating subsidies and enough funds for troubled projects to cover the valid needs for assistance.

Again, we believe it necessary for the Congress to make a clear and unmistakable commitment to preserving our present stock of assisted housing. If choices on priorities have to be made, this one should come first.

Last year Congress, rightly in our view, adopted legislation to focus federal housing assistance on the very lowest income families. It did so knowing that it costs more to assist a household with an income below 50% of median than it costs to assist households with incomes above 70% of median. Public housing operating subsidies, troubled projects subsidies, and Section 8 existing contracts are the three mechanisms which exist to provide these funds. If they are not adequate, projects will fail. If they are public housing, they will become vacant. If they are not, they will be turned back to HUD.

We recognize that there are problems of management and of adequate cost control if the commitment -- which we believe is vital -- to adequate operating assistance is made. We would be happy to work with the committee and its staff in addressing these problems. But solutions which rest either on restricting the level of assistance to unrealistically low levels or on serving households with lesser needs must be regarded as unacceptable from the outset.

FEDERAL SUPPORT FOR LOW INCOME HOUSING PRODUCTION MUST CONTINUE.

If it were not tragic for low income people, it would be ironic that the history of federal housing assistance over the three last decades has been that every time a housing program is sufficiently seasoned so that the bugs have been identified and can be addressed, we abandon it for something else. We appear to be on the verge of doing so again.

Until a better vehicle is in place and running, NLIHC supports continuation of assisted housing production through public housing, the Farmers Home 515/rental assistance housing program, and -- at least for neighborhood based groups and cooperatives -- of the Section 8 program.

Nor do we believe that continuation of these programs is inconsistent with developing and testing new approaches, particularly if we are willing to reaffirm the national commitment to providing decent housing for every American family, including low income families.

> WE RECOMMEND THAT TWO, MUTUALLY CONSISTENT APPROACHES BE INCLUDED IN THIS YEAR'S LEGISLATION: (1) A HIGHLY TARGETED PROGRAM OF HOUSING GRANTS TO STATE AND LOCAL GOVERNMENTS TO BE USED ONLY TO REDUCE THE CAPITAL COST OF PROVIDING ADDITIONAL NEW OR REHABILITATED UNITS TO BE OCCUPIED BY VERY LOW-INCOME HOUSEHOLDS WITH URGENT HOUSING NEEDS AND (2) A MULTI-FAMILY RENTAL HOUSING PRODUCTION PROGRAM DESIGNED TO PROVIDE A SUBSTANTIAL NUMBER OF UNITS FOR LOWER INCOME FAMILIES.

HOUSING GRANTS. The basic objective of any housing grant program should be to serve people with the most critical housing needs, and to provide flexibility in doing so. An adequately designed and constrained housing grant program could accomplish this goal and we would be pleased to work with the committee in developing such a program. While we do not have a full-fledged proposal to present, we are clear that any grant program should have at least the following provisions:

Eligible activities should be limited to providing new or rehabilitated housing to be occupied by very low income families who are (1) living in seriously substandard housing; (2) paying more than half their income for shelter; or (3) displaced by public or private actions. This dual targeting is necessary at least until these critical housing needs are met and will easily absorb the funds that might foreseeably be provided to a housing grant program.

Housing grant funds should not be used for administrative costs.

Adequate civil rights and citizen participation mechanisms should be included, and performance monitoring should be real.

HUD should have some leeway to reward good performance and penalize poor performance. (The mechanism in the administration's proposed rental rehabilitation grant program might be workable for this.)

There are also some things which a housing grant program should NOT do. We oppose inclusion of new construction as an eligible activity in the community development block grant program as insufficiently targeted and likely to draw funds away from the present, neighborhood-based use of CDBG funds for rehabilitation. We would oppose any approach which would make housing grants fungible with CDBG. Finally, we oppose initiating a housing grant program in rural areas. We believe, instead, that it should begin with HUD and focus on urban areas, with a balance-of-state allocation, based on need, which could be used to provide housing assistance in rural areas.

MULTIFAMILY HOUSING PRODUCTION. We welcome the initiative by Senator Dodd in introducing S. 2171. The Coalition believes it is appropriate to give greater emphasis to assisting rental housing production than to single family units. However, we suggest two specific changes: (1) there should be a requirement that at least 40% of the units in each project be subsidized for lower income households and (2) all lower income units provided should remain as rental units for 30 years unless sold, under limited equity arrangements, to their occupants.

THE RURAL HOUSING PROGRAMS OF THE FARMERS HOME ADMINISTRATION SHOULD BE CONTINUED AND MORE EFFECTIVELY DIRECTED TO SERVING LOW INCOME PEOPLE.

The Farmers Home Administration has the only housing delivery system available in many remote rural areas. It is also the only housing agency that has housing staff reasonably well distributed throughout rural America, with experience in providing housing assistance both to home owners and to small, 4-8 unit rental projects.

FmHA programs have been hampered, however, both by inadequate scale and by inadequate subsidies to enable them to assist very low income people. We believe these problems should be addressed directly, through continued targeting and planning requirements, and through provision of funds for rural rental assistance and the never-funded home ownership assistance program for very low income households.

AT LEAST $10 MILLION SHOULD BE PROVIDED FOR A FULL RANGE OF HOUSING COUNSELING SERVICES.

We find the effort to end federal support for housing counseling services is short-sighted and counterproductive. Default counseling has saved more money than it has cost.

More important to the Coalition's concern with low income housing is the role of housing counseling agencies in providing assistance to low income people in solving their immediate, critical housing problems. Particularly if we are to shift to even greater reliance on the existing stock of housing, adequate counseling can be critical to improving the sorry record of the Section 8 existing program in providing shelter to large families, single parent families, and minority families.

# # # # #

THE HOUSING BUDGET AND LOW INCOME HOUSING NEEDS

A compendium of testimony by Cushing N. Dolbeare, President, National Low Income Housing Coalition, before House Subcommittee on Housing, Committee on Banking, Finance and Urban Affairs; House Budget Committee; and Senate Agriculture Committee, March 1982.

This is, by almost any measure, a grim time for housing. New housing production is at its lowest levels in decades. Traditional forms of housing finance are stagnating, or worse. Unemployment of construction workers is approaching 20%. Given these problems and the outcry about them, it is all too easy to forget that the housing crisis for low income people -- whose problems are most acute -- is steadily worsening.

During the last decade, while the housing conditions of most Americans improved markedly, the housing situation of low income people was deteriorating. Low income people have not really shared in the general improvement in income -- but their housing costs have risen far more rapidly than those for middle and upper income people. Displacement is a major problem -- even from subsidized housing. Homelessness is increasing, and affecting families as well as single people. Although the rise in energy costs is decelerating, many low income people still cannot afford adequate heat. Unsubsidized private rental housing construction has dried up, and the Administration is in the process of attempting to retrieve subsidized units already in the pipeline.

This testimony will cover (1) the present housing situation of low income people, drawing on recently published Annual Housing Survey data for 1979 and 1980; (2) some of the major accomplishments of federally subsidized housing programs; (3) the cost of federal housing assistance, both directly and through the tax code; (4) the Administration's housing proposals and their impact; (5) the substantial rent increases for very poor people if food stamps are counted as income; (6) the proposals contained in H.R. 5731, the "Gonzalez bill"; and (7) some recommendations for dealing more adequately with the housing needs of low income people.

THE HOUSING SITUATION OF LOW INCOME PEOPLE

The housing problems faced by low income people are multiple and varied.

Historically, a major focus of housing concern has been on housing and neighborhood quality. Indeed, as recently as 1940, 45% of all occupied units in the United States were either dilapidated or lacked basic plumbing facilities. That figure has now fallen to well below 10%, with those units almost exclusively occupied by poor people.

As the incidence of substandard housing has declined, another major housing problem has arisen for low income people: affordability. Housing costs include not only the mortgage or rent, but also utilities, taxes, insurance, and maintenance (although some or all of the latter costs are typically included in rents). These operating costs, particularly utilities, have skyrocketed in recent years. All of us have felt the pinch of rising energy costs, but the impact has been worst for poor people.

The final major housing problem faced by low income people to a far greater degree than others is availability. Availability may be a problem either because the supply is inadequate or because of discrimination on the basis of race, income source, family composition or for other reasons.

> People with special housing needs, such as handicapped or frail elderly people, large renter households, and migrant farmworkers, face special problems of availability.
>
> So do blacks and other minorities, families with children — especially if there is only a single parent, and households with irregular or very low incomes.

Since 1949, when Congress adopted the national goal of "a decent home and a suitable living environment for every American family" there has been bipartisan support for efforts to deal with the acute housing problems of low income people. Meanwhile, several decades of economic prosperity have created very high housing standards and expectations for most Americans.

Between 1970 and 1979, according to Annual Housing Survey data, the number of occupied housing units increased by almost one quarter (24.9%). Almost two thirds (65.4%) of all households owned or were buying their own homes. The number of units lacking plumbing facilities, a traditional measure of housing quality, dropped by 46%. While average household size fell sharply (from 3.0 to 2.6 persons for owner-occupied units and from 2.3 to 2.0 persons for renter-occupied units), housing units increased slightly in size. The number of units with three or more bedrooms increased by one third. There were sharp increases in the number of elderly households, single-parent households (both male and female heads), and single-person households.

Unfortunately, the cost of housing has increased far more rapidly than household incomes. Between 1970 and 1980:

> Median income for owners rose 104% (from $9700 to $19,800), while median value tripled (from $17,100 to $51,300).
>
> Median renter income rose 66% (from $6,400 to $10,600), while median rents increased by 123% (from $108 to $241).

The income gap between owners and renters continued to grow. In 1970, median renter income was 65% of median owner income; by 1979, it had dropped to 55%. As Table 1 shows, there were more renters than owners at the very lowest income levels (below $7,000), while owners outnumbered renters by more than 10:1 in the top income brackets (above $50,000).

The very rapid recent rise in housing costs, particularly for low income renters, is shown in Table 3A. While median rents for all renters rose by 21% in the three years from 1978 through 1980, median rents for very, very low income renters (below $3,000) rose by 38%. Moreover, at all income levels, the proportion of income spent for shelter was rising, although the median was 25% or more only for households with incomes below $15,000.

While housing costs rose generally, both the amount and the impact of the increase was greatest for low income households. For example, while the number of renter households with incomes below $3,000 per year dropped from 5.8 million to 2.9 million between 1970 and 1979, the number of units in the stock at rents they could afford dropped by 75%, from about 5 million to less than 1.5 million.

Thus, there is a wide and growing "housing gap" for very low income people. Even if all other things were perfect -- which we know they are not, there are more than twice as many renter households with incomes below $3,000 as there are rental units available at 25% of their incomes. Even using a 30% rent-income ratio, there is a gap of more than 1.2 million units at the very bottom of the income scale. (See chart, and Tables 1A, 2 and 3).

The impact of these changes in housing costs has been traumatic for renters at the bottom of the income scale. In 1970, there were 5.8 million renter households (24% of all renters) with household incomes below $3,000 per year. Their median rent was less than $85 per month. By 1980, the number of renter households in this bottom bracket had dropped to 2.7 million (still 10% of all renters), but their median rent was $179 per month.

> In 1970, a family with an income of $3,000 who paid the median rent of $85 spent 34% of its income for shelter, and had $165 monthly left over for all other needs.
>
> In 1980, a family with an income of $3,000 who paid the median rent of $179 spent 72% of its income for shelter and had only $71 left over for all other needs.

What are the characteristics of these 2.7 million renter households with such very low incomes?

> 49% were single individuals, but 51% were in households with two or more people, and 5% had five or more.
>
> 13% were married couples; 6% were male-headed households; and 27% were female-headed households. 27% had children of their own under 18, and 6% had three or more.
>
> 20% were single, elderly people; but 29% were single, nonelderly individuals.
>
> 52% had moved within the last year and 84% had moved within the last ten years.
>
> Only 19% lived in subsidized housing.
>
> 59% paid 60% or more of their income for rent. Only 4% paid less than 25%.
>
> 46% lived in housing built before 1939.
>
> 10% lived in units lacking plumbing facilities. 4% were overcrowded.
>
> 29% were black; 8% were of Hispanic origin.
>
> 20% lived in the northeast; 27% in north central states; 37% in the south and 16% in the west.
>
> 46% lived in central cities; 31% lived in nonmetropolitan areas. All had incomes less than 75% of the poverty level.

These households are the poorest of the poor, but in 1980 they were less than one third of all households with incomes below the poverty level. There were also another 3.3 million renter households with incomes above $3,000, but still below the poverty level, and 4.9 million owner-occupants below the poverty level.

In other words, when we speak of low income housing needs, we are talking about millions of people: 29 million in all, including more than 11 million children (4 million of them under six) and 4 million elderly people.

SOME ACCOMPLISHMENTS OF LOW INCOME HOUSING PROGRAMS

1982 marks the 45th anniversary of the adoption of the U.S. Housing Act of 1937, which established the public housing program. In the ensuing decades, our subsidized housing inventory has risen to about 4.5 million units: 3.4 million through programs of the Department of Housing and Urban Development (HUD) and the rest in rural areas through the Farmers Home Administration (FmHA) of the Department of Agriculture. This is about double the number of units built by the private sector in a single good year.

In contrast, as President Reagan's Commission on Housing has pointed out, there are approximately 20 million households with incomes below 50% of median and more than 30 million households with incomes below 80% of median.

Small wonder, then, than fewer than one quarter of all households with incomes below the poverty level are living in federally assisted housing.

Most subsidized housing assistance has been given to renters, particularly through HUD programs. The Farmers Home Administration has placed more emphasis on home ownership programs. Table 4 gives current estimates on the number of occupied subsidized units. The table includes occupied units provided under all programs of HUD and FmHA.

Yet, despite their inadequate scale, our low income housing efforts have made a critical difference to millions of low income households. While only 11% of all rental units are subsidized, almost three fifths (57%) of the units renting for less than $100 monthly are subsidized, as are one fifth (22%) of the units renting for $100-149. Perhaps more important, as Table 5 shows, subsidized housing provides shelter for almost one quarter of all very poor renter households (incomes below the poverty level). Almost one third (32.7%) of all very poor elderly renters live in assisted housing, as do comparable proportions of very poor black renters (33.1%) and female-headed renter households (31.2%). Very poor Hispanic households and white households are less well served: 17.7% of very poor Hispanic renters and 20.0% of very poor white renters are in subsidized housing. Finally, it should be noted that public housing serves poor renters living in cities better than those elsewhere: 29.4% of very poor renters in central cities live in subsidized housing, compared with 19.4% outside of metropolitan areas.

Perhaps the most reliable, relatively recent data on characteristics of households living in federally assisted housing appears in a recent Census Bureau report on "Characteristics of Households and Persons Receiving Noncash Benefits," containing data from the March 1980 Current Population Survey. The data, which include rental housing assisted under all programs, are summarized in Table 7.

The information belies some widely held assumptions about federally subsidized housing:

Almost three-fifths of the households are white.

Over one-third are elderly.

About two-fifths worked at least part of the time.

Half had household incomes below $5000. One eighth had household incomes below $2500.

Almost half had incomes below the poverty level and over three-fifths had incomes below 125% of the poverty level.

While only 15% of assisted households consisted of five or more persons, they were among the poorest. Two thirds of the five and six person households and three quarters of the households with seven or more persons had incomes below the poverty level.

THE COST OF FEDERAL LOW INCOME HOUSING PROGRAMS

While there is a great variety of federal housing programs, there are several patterns to the way they are subsidized. It is useful to analyze housing subsidies in terms of three principal components of housing costs: (1) the capital cost of the structure or unit (including site acquisition, site preparation, and the cost of designing and building the housing); (2) financing, since subsidized housing is financed exclusively through long-term loans; and (3) operating costs, including management, utilities, maintenance, and taxes.

Briefly, all of the HUD and FmHA lower income housing programs provide financing subsidies. This is done through tax-exempt bonds (public housing and some Section 8), through payment of part of the interest (Section 235 home ownership, Section 236 rental housing, and the "new" Section 202 housing for elderly and handicapped); or through direct loans (Farmers Home and the "old" 202 program). [For reasons too complex to discuss here, FmHA loans are sometimes referred to as "insured", but the money is borrowed from and repaid to FmHA.]

It has never been possible to provide affordable housing for very low income people (incomes below the poverty level or 50% of median) with financing subsidies alone. Hence, programs which receive only financing subsidies either do not serve low income people or, if they attempt to, run into serious financial problems. (This has been notably true of the 236 rental housing program.)

The primary capital subsidy programs are public housing and Section 8. Under the public housing program, the federal government signs an "annual contributions contract" (ACC) and agrees to pay the principal and interest to retire the bonds financing the projects. Under the Section 8 new construction and substantial rehabilitation programs, the fair market rents on which the subsidy is based reflect the cost of paying off the financing for the project. The cost differential between Section 8 new construction and Section 8 existing can be regarded as a capital subsidy. The Farmers Home Administration has two very small programs which pay partial capital subsidies: the very low income repair grant program and the farm labor housing grant program.

The rent supplement program -- now being phased out -- is similar to Section 8 in that part of the subsidy offsets the cost of retiring the loans to finance the project.

For two decades, operating costs alone have been more than most very low income people can afford at a reasonable percentage of their income. Moreover, operating costs have been rising far more rapidly than incomes. This has forced the provision of operating subsidies for programs serving poor people.

> In public housing, operating subsidies are provided in a separate, line-item appropriation calculated according to a formula which few claim to understand.
>
> The designers of the Section 8 program recognized the need to subsidize operating costs, but relied on market discipline to limit them. Thus, Section 8 contracts are limited by "fair market rents" for comparable unsubsidized housing. [One major problem with this concept is that "comparables" have been hard to find as unassisted rental housing construction has dried up.] Annual adjustments are made to reflect rising costs in the market area.
>
> Other programs which provide funds to cover operating costs are the FmHA rural rental assistance program and HUD's rent supplement program. Rural rental assistance is used together with the 515 1%-interest-rate program; rent supplements have been widely used with the similar HUD 236 program. Section 8 subsidies have also been linked with 236 and 515 projects to make them viable for very low income people.

Not only is housing subsidized in a variety of ways, but it is difficult, in looking at the budget, to get a true picture of subsidized housing costs. The three major elements of "the low income housing budget" are (1) outlays for housing payments; (2) budget authority for additional housing assistance; and (3) authorization of credit for subsidized loans (as well as unsubsidized and insured loans).

> The level of housing payments is largely uncontrollable: it is the cumulative cost of all of the contracts for housing assistance ever signed under all of the various subsidy programs which provide long-term assistance. Basically, these payments cover capital and financing costs, along with some operating assistance. In addition, annually appropriated operating subsidies for public housing and some lesser operating subsidies are reflected in these housing payments. They can be reduced only by jeopardizing the viability of housing projects or by raising rents to unaffordable levels.
>
> Budget authority for incremental assistance easily misunderstood. Because assistance is provided under long-term contracts (15-30 years), budget authority is the maximum annual assistance multiplied by the term of the contract. This is equivalent, for an individual, of purchasing a house with a 20-year mortgage and estimating its cost by including all the principal, interest, taxes, maintenance, utilities and other expenses for the 20-year period. Few houses would cost less than $500,000 if calculated that way! The current "overhang" of budget authority represents the cost of commitments under already signed contracts.
>
> Finally, there is the credit authorization, primarily for FmHA loans. There is a separate appropriation each year to reimburse the Rural Housing Insurance Fund for the cost of subsidizing FmHA interest rates and the small losses incurred under FmHA programs.

This review of housing subsidy approaches is essential to understanding both the complexity of housing assistance programs and the manifold HUD and FmHA programs which have been adopted and refined over the years in an effort to find satisfactory approaches to the dilemma of how best to provide adequate housing assistance while avoiding either waste or windfalls.

There has been much rhetoric, particularly in these times of concern about the federal deficit, with the cost of low income housing programs. There is a threefold problem here: (1) to provide adequate levels of assistance; (2) to identify what low income housing really costs; and (3) to avoid waste and unnecessary costs.

There would be no need for low income housing programs if providing shelter did not cost more than low income people can pay. This truism is worth underscoring. Ignoring it leads to efforts to save money by either serving a higher income group -- bypassing the poorest households -- or in cutting back on assistance levels so that projects become unviable. Our present inventory of assisted housing is a valuable national resource which would cost many times as much to replace as it would to maintain it adequately.

Instead of focussing on the high cost of budget authority for low income housing -- a freak of the budget process which seriously jeopardizes our capacity to expand housing assistance -- let us consider how little, after 45 years, we are spending for this major human need.

- o Outlays for low income housing assistance have never, in any year, been even 1% of total federal outlays.

- o The cost of housing-related tax expenditures to the Treasury in 1981 alone exceeded THE CUMULATIVE OUTLAYS for low income housing assistance under all of the programs of HUD and its predecessor agencies from the adoption of the U.S. Public Housing Act of 1937 through 1981.

- o Compared to the anticipated cost of housing-related tax expenditures, primarily home owner deductions, the $250 billion in budget authority committed to long-term contracts for federal housing assistance is almost trivial. Unless constrained, and neither Congress nor the Administration appears inclined to address this issue, foregone revenues for the rest of this century will be many trillions of dollars.

There are ways of reducing the cost of housing assistance for low income people. One of the most effective approaches would be to focus the provision of housing assistance to individual households, on the one hand, and to public, nonprofit, and limited equity housing owners on the other.

THE ADMINISTRATION'S HOUSING PROPOSALS

Last year, low income housing received the largest cut in budget authority of any federal program. This year, again, low income housing bears the brunt of the $56 billion in budget cuts proposed by President Reagan. Measured in "budget authority", or spending commitments, the 1983 budget provides $32 billion less than "current services", or the amount needed to maintain federal programs at their present levels. However, since there is a $30 billion increase above current services in budget authority for national defense, the total cut in all other programs is $62 billion.

$23 billion, or 37%, of this cut comes from low income housing programs. This is by far the largest cut proposed for any activity of the federal government. In fact, it is almost $5 billion more than the combined total of all the other cuts in education, training, employment, social services, health (including Medicare and Medicaid), food stamps, welfare, and other income security, safety net programs. Indeed, the 1983 increase in the military budget could be funded out of the 1982 and 1983 low income housing cuts alone.

In short, the Reagan Administration would reverse the slow progress we have been making in expanding low income housing programs and, instead, curtail the present level of assistance, particularly for new or rehabilitated assisted housing units. It would get rid of many existing subsidized units. And it would raise rents to the point where federally subsidized low income housing may cost more than unsubsidized housing.

If adopted by the Congress, the impact of the budget and legislative proposals would be disastrous for low income people.

o Hundreds of thousands of low income units already approved for subsidy will never be built or rehabilitated, because the subsidy commitments will be withdrawn.

The Administration proposes cancellation of hundreds of thousands of commitments for new or rehabilitated housing units, already approved under the Section 8 and public housing programs. A net total 300,000 of the 700,000 units now "in the pipeline" would be lost forever. This loss comes at a time when the stock of affordable rental housing units is shrinking rapidly and almost one fifth of all construction workers are unemployed.

o Rents for the 3 million families living in lower income housing would be sharply increased. The Administration will propose legislation to require tenants to pay their entire utility bills and to count food stamps as income. [Note: The administration's legislative proposals, transmitted to Congress after this testimony was delivered, did not include establishment of minimum rents. However, we understand that regulations to eliminate "negative rents" (payments to tenants who pay their own utilities and whose utility allowances are higher than their "tenant contribution" or rent). This would have the result of making utility bills the minimum rent for these households. HUD is also preparing regulations to eliminate medical and other deductions from income.] This could double or treble rents for many households. Moreover, present deductions from income would be ended. Rent increases would be phased in over five years (the present 10% cap on rent increases would be raised to 20%).

These proposals hit hardest on very low income people, who receive the maximum food stamp allotments. Their rents would go up by $40 or more. People in states with low welfare grants would be worst off. (See below, and tables, for the impact of this proposal.)

The proposal that tenants pay the full cost of their utilities [where they exceed regular rent due] is even worse, particularly in cold climates or older, poorly insulated projects, where utility bills average well over $100 per month. The National Low Income Housing Coalition, and others, have long contended that subsidized housing residents in fact often pay far more than 25% of their incomes for rent, because of the inadequacy of utility allowances.

Now the Bureau of the Census confirms this view. As Table 5 shows, 16% of households living in subsidized housing paid more than 50% of their incomes for shelter, and one quarter paid more than one-third of their incomes.

We urge Congress to review these facts and actual rent-income ratios and to restore the original intent of the Brooke amendment, which was to limit housing expenditures, including utilities, to 25% of income.

Federal rent subsidies would be reduced by 15-20% in the Section 8 existing program and tenants would have to pay the extra costs out of their own pockets, along with the increased rents. It would be even harder for large households to find quarters.

This would be done under the "modified Section 8 existing program" by giving certificates that cover the difference between 30% of tenant income and a reduced fair market rent (about 15-20% below present levels because of changes in how it would be calculated). Tenants would then negotiate their own rents, paying less if they could find a place for less; paying the extra if they couldn't.

As proposed by the Administration, this constitutes a hidden rent increase for tenants being switched to the new program. I have queried a broad range of Section 8 housing administrators -- attending two training conferences -- on whether their clients could find housing in their communities at 80% of current fair market rents. Not one thought it would be possible.

Moreover, there is clear evidence, both from the Experimental Housing Allowance Program and the Section 8 existing program, that vouchers can meet only a part of the low income housing needs. They serve households, essentially, whose primary problem is affordability. But they do not provide shelter for households the private market is unwilling or unable to serve: large families, single-parent families, minority families. Even at present fair market rents, half of all households receiving Section 8 certificates are unable to find units within their alloted time period of sixty days. The proportion is far higher for minorities, female-headed households, and households now living in substandard housing.

There is no provision in this new voucher program to provide annual adjustments for rent increases. Expiring Section 8 existing contracts are to be converted to the new program.

Some public housing projects would have to close. Services and maintenance would have to be curtailed in those remaining open. Several thousand low income families living in public housing would be displaced because their homes would be demolished. The level of operating subsidies for public housing is simply inadequate to maintain it: about two thirds of estimated need.

Homeowners facing default would no longer receive housing counseling to assist them in retaining their homes. The housing counseling program would be ended.

150,000 families living in rent supplement projects would have no assurance, beyond five years, that they would receive housing assistance. Present rent supplement contracts would be ended, and tenants given vouchers instead.

The rural housing programs of the Farmers Home Administration would be cut to one-third of their present level. They are to be virtually terminated in 1984.

These proposals are made at a time of housing crisis. New production is at its lowest level in two generations. Rents in the private market are beyond the reach of the millions of low income households these programs were intended to help.

In short, the budget proposals offer no hope to low income people: either to those now living in low income housing or to the hundreds of thousands more on the waiting lists. They must be rejected.

THE IMPACT OF COUNTING FOOD STAMPS AS INCOME

In 1979, an estimated 922,850 households living in housing subsidized through the HUD Section 8 and public housing programs received food stamps. This is about half of the total number of households living in these subsidized units. About one third of the food stamp recipients in subsidized housing were elderly; just over half were nonelderly families headed by a woman.

Food stamp recipients are among the poorest low income housing residents. In 1979, 55% had incomes below $3000 and another 30% had incomes between $3000 and $5000. Moreover, 83% of the households living in public housing or Section 8 with incomes below $3000 received food stamps, as did 37.6% of residents with incomes between $3000 and $5000. The proportion of residents with incomes between $5000 and $10000 who received food stamps dropped to 23.7%, while less than 0.1% of residents with incomes above $10,000 also received food stamps. (Source: Derived from information on characteristics of food stamp households in assisted housing contained in "The Impact of Including Housing Assistance as Income in Determining Food Stamp Eligibility and Benefits: Report to the Congress," Food and Nutrition Services, USDA; information on incomes of public housing and Section 8 tenants in 1979 HUD Statistical Yearbook; and information on occupied units in 1981 HUD Budget Summary.)

These facts are doubly significant because the impact of counting food stamps as income falls most heavily on people with the very lowest incomes. As Table 4 shows, both the absolute and relative increases are greatest for tenants with the very lowest incomes. Rents for elderly households with incomes below 10% of median would increase by 42%, and households in this income bracket would have only $70 monthly for all nonhousing expenses.

The impact on larger households in the bottom income bracket is even more startling: rents for households of three to six persons roughly triple, once the increases were fully phased in, and these households would have about $50 left each month for all of their nonhousing needs.

Both the absolute and relative rent increase for households living in assisted housing with incomes between 11-20% of median or 21-30% of median are lower, but the increases would still be substantial for households in the 11-20% of median bracket.

Still another perspective on the impact of the change is provided by a state-by-state analysis, shown in Table 5, of how rents would change for a mother on welfare, who did not work, with two children. In no state is the increase in rent less than 20%; in many states, rents would double, and in Mississippi they would almost quadruple. The biggest absolute and relative increases come in the states with the lowest welfare grants and would exacerbate the already great disparities in income.

Finally, we should note that many assisted housing tenants already are paying far more for rent than the theoretical program models assume. Although rents, including utilities, are supposedly limited to 25% of income, fully one quarter of the residents of assisted housing are paying more than one third of their incomes, when full utility costs are included. 13% are paying 60% or more of their incomes -- compared to 16% of all unsubsidized tenants. If the Administration's proposal to set minimum rents to cover utility costs is adopted, the proportion of low income housing residents with very high cost burdens will rise sharply.

These proposals undermine the very purpose of federal housing assistance programs: to provide low income people with decent housing at affordable rents. Their impact, instead, will be to make unsubsidized housing unaffordable for people who need it most. The result will be that they will be forced to leave, and most of them will have no place to go.

COMMENTS ON H.R. 5731 -- THE "GONZALEZ BILL"

The National Low Income Housing Coalition welcomes the effort to design a counterproposal which will effectively address our current housing situation. We hope that this will be a bipartisan and ultimately successful effort.

While we generally endorse the direction of the Gonzalez bill, we recommend a number of changes:

- Considering the enormous needs of low income people, the level of low income housing assistance should be increased.
- Funds should be provided for Section 8 new construction and rehabilitation, at least sufficient to maintain present commitments and to provide additional Section 8 assistance to nonprofit, limited equity, and community based housing organizations so they can continue their low income housing activities.
- Rental housing production should be given greater emphasis than single family production. Moreover, the rental housing production program proposed in H.R. 5731 should be improved by (1) requiring that 40% of the units provided be subsidized for lower income households; (2) giving clear priority to proposals which provide higher levels for lower income people; (3) requiring that all lower income units remain as rental units for 30 years unless sold, under limited equity arrangements, to their occupants.

We urge your adoption of these recommendations and look forward to working with the Committee as it considers this important legislation.

WHERE NEXT: SOME LONG-RANGE PROPOSALS

The National Low Income Housing Coalition believes that our national housing policy must start with the principle that affordable access to housing is a basic human right. This right must be firmly established as the basis for federal housing policy and programs. We believe the federal government has a fundamental responsibility to assure that everyone living in this country is able to obtain decent housing at affordable costs.The federal resources necessary to make this right a reality for low income people can and should be provided. To this end, we support:

- Adoption of an adequately funded entitlement, income based housing assistance program to enable low income people to obtain decent housing at costs they can afford.

- Expansion of production and preservation programs to meet those low income housing needs which cannot be met by an income-support program alone.

- A strong reaffirmation of the federal government's rolein guarenteeing fair access to housing by all citizens, including strengthening of the federal fair housing law and its enforcement.

- Restructuring tax policy to shift budgetary resourcesfrom those who have to those who do not. The federal cost of housing-related income tax expenditures now tops $40 billion annually -- more than five times the cost of housing assistance presently provided for low income people. The bulk of these tax expenditures benefit people in the top quarter of the income distribution.

- A strong role for community based, nonprofit organizations, in the implementation of housing programs, along with the availability of federal assistance to meet a broad range of housing needs at the neighborhood and community level.

- A strong reaffirmation of the federal government's continuing commitment to retaining the current stock of federally assisted and insured housing, now occupied by low and moderate income people, for their use. This includes all present public housing, HUD-assisted, HUD-insured, and HUD-held units, as well as units assisted by the Farmers Home Administration. The necessary funds should be provided to maintain this housing in viable condition.

- Modification of monetary and credit policies to counteract the high financing costs for housing and the credit-related sharp fluctuations in residential construction which increase the costs, prices, and rents of all housing.

- A strong reaffirmation of the responsibility of the federal government to bring its resources to bear to prevent displacement of low income people from their homes and neighborhoods by either public or private action.

We urge this committee to remember that housing is more than bricks and mortar. Our housing is where we live: it shapes our lives, our families, and our communities.

The importance which we give to housing reflects our values as a society. Do we care that millions of children must live in homes and neighborhoods that violate basic standards of safety and decency? Do we care that millions of old people must end their lives without dignity or the assurance of a sound roof over their heads and heat in their homes? Do we still believe that the federal government must play a role in ending injustice, and in providing resources and assistance where no one else can do so? The National Low Income Housing Coalition is convinced that the answers to these questions can and must be "YES".

1980: Comparison of Renter Households and Affordable Units

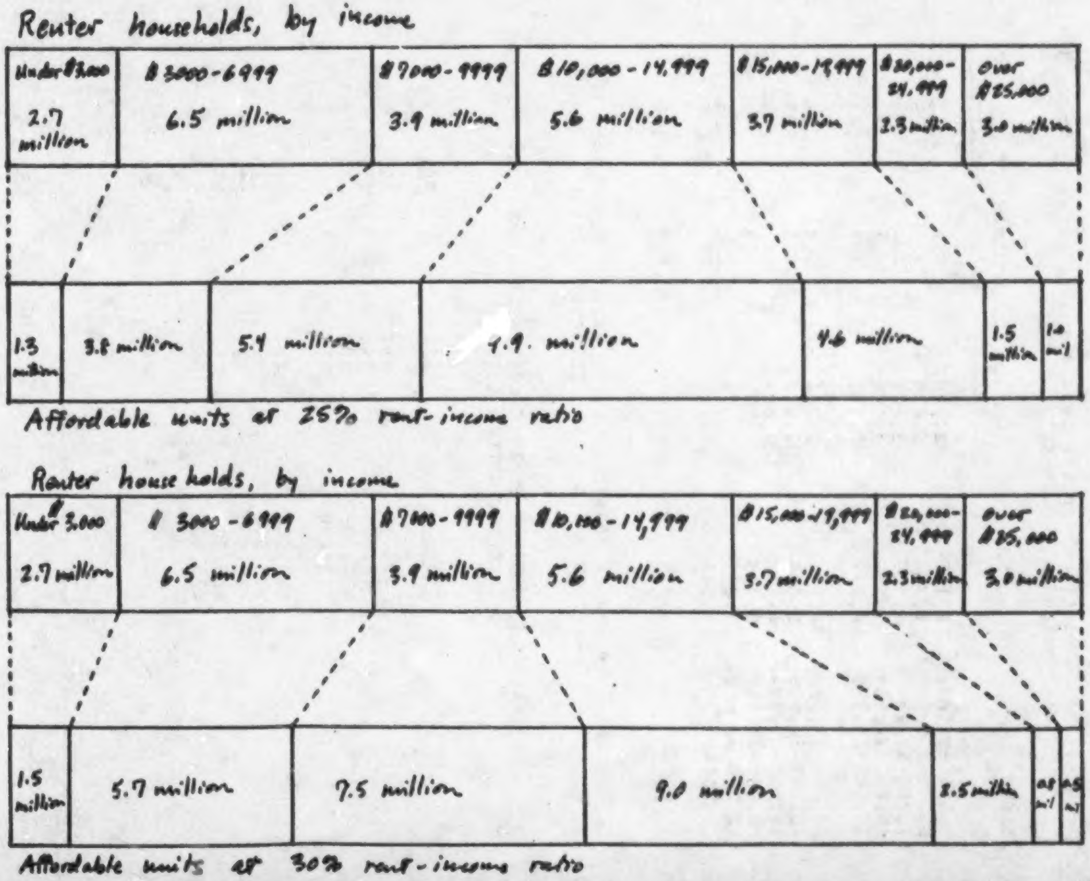

TABLE 1. Income distribution for owners and renters, by race, 1980. (Households in thousands).

Income	Owners	Renters		
		All	Black	Hispanic
$3,000 or less	2,155	2,748	788	232
$3,000-6,999	5,750	6,479	1,483	616
$7,000-9,999	4,367	3,862	697	422
$10,000-14,999	7,217	5,553	841	519
$15,000-19,999	6,977	3,672	477	264
$20,000-24,999	6,707	2,263	264	156
$25,000-34,999	9,814	1,984	203	101
$35,000-49,999	6,002	699	61	29
$50,000-74,999	2,445	207	13	4
$75,000 or more	1,082	88	-	6
Total	52,516	27,556	4,827	2,349
Median	$19,800	$10,600	$7,600	$9,300

Source: 1980 Annual Housing Survey, Part C, Financial Characteristics of the Inventory.

TABLE 1A. MONTHLY SHELTER COST AT 25% AND 30% OF INCOME FOR SELECTED INCOME LEVELS

Income	25%	30%
$3,000	$62	$75
$7,000	146	175
$10,000	208	250
$15,000	312	375
$20,000	417	500
$25,000	521	625
$35,000	729	875
$50,000	1042	1250
$75,000	1562	1875

TABLE 2. RENTER HOUSEHOLDS AND AFFORDABLE UNITS AT 25% RENT-INCOME RATIO, 1980.

Income	Households	Units	Gap/Surplus	Cumulative
$3,000 or less	2,748	1,301	-1,447	-1,447
$3,000-6,999	6,479	3,807	-2,672	-4,119
$7,000-9,999	3,862	5,415	+1,553	-2,566
$10,000-14,999	5,553	9,920	+4,367	+1,801
$15,000-19,999	3,672	4,576	+904	+2,705
$20,000-24,999	2,263	1,503	-760	+1,945
$25,000-34,999	1,984	814	-1,170	+775
$35,000 or more	994	215	-775	0
Total	27,556	27,556	-	-

Source: Estimated by NLIHC from data in Annual Housing Survey, Part C, Financial Characteristics of the Inventory.

TABLE 3. RENTER HOUSEHOLDS AND AFFORDABLE UNITS AT 30% RENT-INCOME RATIO, 1980.

Income	Households	Units	Gap/Surplus	Cumulative
$3,000 or less	2,748	1,513	-1,235	-1,235
$3,000-6,999	6,479	5,694	-785	-2,020
$7,000-9,999	3,862	7,496	+3,634	+1,614
$10,000-14,999	5,553	9,012	+3,459	+5,073
$15,000-19,999	3,672	2,545	-1,127	+3,946
$20,000-24,999	2,263	791	-1,472	+2,424
$25,000 or more	2,978	504	-2,494	0
Total	27,556	27,556	-	-

Source: Ibid.

TABLE 3A. CHANGES IN MEDIAN RENTS AND MEDIAN RENT-INCOME RATIOS

Income	Median Rent			Median rent-income ratio		
	1980	1979	1978	1980	1979	1978
$3,000 or less	$179	$147	$130	72+%	60+%	60+%
$3,000-6,999	187	172	165	47	44	42
$7,000-9,999	222	205	193	32	31	29
$10,000-14,999	249	232	214	25	24	22
$15,000-19,999	274	252	233	20	18	17
$20,000-24,999	296	277	256	17	16	14
$25,000-34,999	327	303	284	14	13	13
$35,000-49,999	362	337	326	12	11	11
$50,000-74,999	393	401	347	9-	10-	8-
$75,000 or more	423	359	283	7-	6-	5-
All renters	241	217	200	27	26	25

Source: Ibid. Ratios above 60% or below 10% are NLIHC estimates.

TABLE 4 ESTIMATED SUBSIDIZED UNITS AS OF SEPTEMBER 30, 1981

Agency	Program	Units
HUD	Public housing	1,204,000
	202 housing for elderly and handicapped (original program)	44,392
	Revised program (post-1974)	55,994
	Rent supplements	157,779
	236 rental housing assistance	537,206
	Section 8 housing assistance payments	1,318,927
	Subtotal, rental housing	3,318,298
	Less 202 units also receiving Section 8	-55,994
	Less estimated 236 units also receiving Section 8 assistance	-95,000
	Less estimated 236 units also receiving rent supplement assistance	-66,000
	Net rental units	3,101,304
	235 home ownership assistance	
	Old program (pre-1974)	158,226
	Revised program	82,313
	Net home ownership units	240,539
	Total HUD-subsidized units	3,341,843
FmHA	515 rental housing (estimated units)	210,000
	502 home ownership loans	1,639,309
	504 very low income repair grants	39,269
	Subtotal, home ownership	1,678,578
	Less estimated unsubsidized 502	-540,000
	Net FmHA home ownership units	1,138,578
	Project loans and grants:	
	Rural rental assistance (with 515)	1,517
	Farm labor housing loans (514)	1,395
	Farm labor housing grants (516)	188
	Site loans (524)	165
	Self-help housing grants	348
	Supervisory/technical assistance (525)	57
	Total FmHA*	1,151,000
	GRAND TOTAL	4,493,000

* Includes rough estimate of net units provided through project loans and grants (primarily farm labor housing, since other project loans listed here are coupled with 515 or 502 assistance).

Source: Estimated from HUD, FmHA and CRS sources.

TABLE 5 HOUSEHOLDS SERVED BY ASSISTED RENTAL HOUSING PROGRAMS

	Total	Below Poverty Levels	
		Below 100%	Below 125%
All households			
Total	82,368	10,968	15,557
Renter-occupied	16,487	6,063	8,153
Living in subsidized housing	2,777	1,430	1,866
Percent of renters	10.4%	23.6%	22.9%
Households with children under 18 years old			
Total	34,329	4,928	6,607
Renters	10,036	3,126	3,949
Living in subsidized housing	1,297	787	917
Percent of renters	12.9	25.2	23.2
Householder 65 or over			
Total households	16,912	3,188	5,137
Renters	4,128	1,237	1,931
Living in subsidized housing	956	405	652
Percent of renters	23.2%	32.7%	33.8%
White householder			
Total households	71,872	7,828	11,593
Renters	21,135	3,934	5,549
Living in subsidized housing	1,612	745	1,029
Percent of renters	7.6%	20.0%	18.5%
Black householder			
Total households	8,847	2,864	3,588
Renters	4,618	1,941	2,383
Living in subsidized housing	1,075	643	771
Percent of renters	23.6%	33.1%	32.8%
Spanish-origin householder			
Total households	3,906	956	1,317
Renters	2,085	685	908
Living in subsidized housing	223	121	155
Percent of renters	10.7%	17.7%	17.1%

	Total	Below Poverty Levels Below 100%	 Below 125%
Inside central cities			
Total households	24,473	4,106	5,743
Renters	11,343	2,878	3,895
Living in subsidized housing	1,534	846	1,091
Percent of renters	13.5%	29.4%	28.0%
Outside metropolitan areas			
Total households	26,296	4,224	5,935
Renters	6,526	1,801	2,357
Living in subsidized housing	688	349	459
Percent of renters	10.5%	19.4%	19.4%
Female-headed household			
Total	9,082	2,972	3,666
Renters	4,529	2,112	2,492
Living in subsidized housing	1,029	674	771
Percent of renters	22.7%	31.2%	30.9%

Source: Current Population Reports, "Characteristics of Households Receiving Noncash Benefits, 1980," CPR P-60, No. 128.

TABLE 6 . COMPARISON OF RENT-INCOME RATIOS FOR SUBSIDIZED AND UNSUBSIDIZED HOUSING TENANTS, 1980

Rent-income ratio	Subsidized No.	 %	Unsubsidized No.	 %
Under 10 percent	117	4.0	1,114	5.1
10-14 percent	228	7.8	2,605	11.8
15-19 percent	445	15.1	3,570	16.8
20-24 percent	664	22.6	3,153	15.9
25-34 percent	644	22.6	4,269	20.5
35-49 percent	292	10.0	3,207	14.6
50-59 percent	91	3.1	1,149	5.2
60 percent or more	385	13.1	3,358	15.6
Not computed	65	2.2	1,518	6.6
Total	2,932	25	23,942	27

TABLE 7 1980 CHARACTERISTICS OF HOUSEHOLDS LIVING IN SUBSIDIZED RENTAL HOUSING. (Households in thousands.)

CHARACTERISTICS	TOTAL	MED.INC.	-100% POV	%	-125%	%
ALL HOUSEHOLDS	2511	$4978	1170	46.5%	1573	62.6%
INSIDE METRO AREAS	1858	4959	867	46.6	1176	63.2
INSIDE CENTRAL CITIES	1373	4880	692	50.4	921	67.0
OUTSIDE CENTRAL CITIES	485	5386	175	36.0	256	52.7
OUTSIDE METRO AREAS	653	5078	302	46.2	397	60.7
NORTHEAST	794	6172	279	35.1	415	52.2
NORTH CENTRAL	538	4696	276	51.3	349	64.8
SOUTH	809	4617	476	58.8	583	72
WEST	370	4651	139	37.5	227	61.3
WHITE	1473	4822	592	40.1	863	58.5
BLACK	967	5367	549	56.7	671	69.3
SPANISH ORIGIN	202	6146	99	49.0	126	62.3
FAMILY HOUSEHOLDS	1491	6812	718	48.1	894	59.9
MARRIED COUPLES	596	9507	151	25.3	230	38.5
MALE HOUSEHOLDER	28	0	8	28.5	15	53.5
FEMALE HOUSEHOLDER	867	5325	558	64.3	650	74.9
NONFAMILY HOUSEHOLDS	1020	3955	452	44.3	680	66.6
MALE HOUSEHOLDER	28	0	8	28.5	15	53.5
FEMALE HOUSEHOLDER	792	3845	363	45.8	542	68.4
HOUSEHOLDER AGED 15-24	289	6227	143	49.4	174	60.2
AGED 25-34	543	6708	269	49.5	337	62.0
AGED 35-44	339	7100	180	53.0	210	61.9
AGED 45-54	221	6286	104	47.0	136	61.5
AGED 55-64	256	4720	125	48.8	164	64.0
65 OR OVER	863	4087	349	40.4	552	63.9
SINGLE PERSONS	980	3892	443	45.2	662	67.5
TWO PERSONS	494	6425	171	34.6	235	47.5
THREE PERSONS	436	6758	186	42.6	241	55.2
FOUR PERSONS	277	7054	147	53.0	178	64.2
FIVE PERSONS	159	6861	107	67.2	124	77.9
SIX PERSONS	83	4245	54	65.0	63	75.9
SEVEN OR MORE	82	8895	62	75.6	71	86.5
MEMBERS UNDER 19	1173	6475	659	56.1	797	67.9
TOTAL PEOPLE	2680	6516	1711	63.8	2007	74.8
WORKED IN 1979	989	8283	312	31.5	434	43.8
DID NOT WORK	1456	3981	854	58.6	1128	77.4

Source: "Characteristics of Households and Persons Receiving Noncash Benefits, 1979 (Preliminary data from the March 1980 Current Population Survey)," Table 5. Bureau of the Census, Current Population Reports, Series p-23, No. 110.

TABLE 7 CONT'D. CHARACTERISTICS OF HOUSEHOLDS IN SUBSIDIZED RENTAL HOUSING, 1980 (Percent distribution).

CHARACTERISTICS	TOTAL	MED.INC.	BELOW 100% POV.	BELOW 125% POV
ALL HOUSEHOLDS	100%	100%	100%	100%
INSIDE METRO AREAS	73.9	99.6	74.1	74.7
INSIDE CENTRAL CITIES	54.6	98.0	59.1	58.5
OUTSIDE CENTRAL CITIES	19.3	108.1	14.9	16.2
OUTSIDE METRO AREAS	26.0	102.0	25.8	25.2
NORTHEAST	31.6	123.9	23.8	26.3
NORTH CENTRAL	21.4	94.3	23.5	22.1
SOUTH	32.2	92.7	40.6	37.0
WEST	14.7	93.4	11.8	14.4
WHITE	58.6	96.8	50.5	54.8
BLACK	38.5	107.8	46.9	42.6
SPANISH ORIGIN	8.0	123.4	8.4	8.0
FAMILY HOUSEHOLDS	59.3	136.8	61.3	56.8
MARRIED COUPLES	23.7	190.9	12.9	14.6
MALE HOUSEHOLDER	1.1	—	.6	.9
FEMALE HOUSEHOLDER	34.5	106.9	47.6	41.3
NONFAMILY HOUSEHOLDS	40.6	79.4	38.6	43.2
MALE HOUSEHOLDER	1.1	–	.6	.9
FEMALE HOUSEHOLDER	31.5	77.2	31	34.4
HOUSEHOLDER AGED 15-24	11.5	125	12.2	11.0
AGED 25-34	21.6	134.7	22.9	21.4
AGED 35-44	13.5	142.6	15.3	13.3
AGED 45-54	8.8	126.2	8.8	8.6
AGED 55-64	10.1	94.8	10.6	10.4
65 OR OVER	34.3	82.1	29.8	35.0
SINGLE PERSONS	39.0	78.1	37.8	42.0
TWO PERSONS	19.6	129.0	14.6	14.9
THREE PERSONS	17.3	135.7	15.8	15.3
FOUR PERSONS	11.0	141.7	12.5	11.3
FIVE PERSONS	6.3	137.8	9.1	7.8
SIX PERSONS	3.3	85.2	4.6	4.0
SEVEN OR MORE	3.2	178.6	5.2	4.5
MEMBERS UNDER 19 TOTAL PEOPLE	46.7	130.0	56.3	50.6
WORKED IN 1979	39.3	166.3	26.6	27.5
DID NOT WORK	57.9	79.9	72.9	71.7

SOURCE: CHARACTERISTICS OF HOUSEHOLDS AND PERSONS Source: "Characteristics of Noncash Benefits, 1979 (Preliminary data from the March 1980 Current Population Survey)," Table 5. Bureau of the Census, Current Population Reports, Series p-23, No. 110.

TABLE 8 IMPACT ON RENTS OF COUNTING FOOD STAMPS AS INCOME, SECTION 8 TENANTS, 1981 INCOME FIGURES.

FOR PRESENT TENANTS WITH RENTS AT 26% OF INCOME

TENANTS WITH INCOMES OF UNDER 10% OF MEDIAN

HOUSEHOLD SIZE	GROSS INCOME	OLD RENT	NEW RENT	$ INCREASE	% INCREASE	$ REMAINING
ONE	1242	26.28	36.4	10.12	38.5	67.09
TWO	1196	19.13	44.63	25.5	133.2	55.03
THREE OR FOUR	1459	18.23	69.32	51.09	280.2	52.26
FIVE OR SIX	1704	21.3	96.54	75.24	353.2	45.46
NINE OR MORE	1838	22.97	98.21	75.24	327.5	54.95
ELDERLY	1242	24.07	34.19	10.12	42	69.31

TENANTS WITH INCOMES OF 11-20 PERCENT OF MEDIAN

HOUSEHOLD SIZE	GROSS INCOME	OLD RENT	NEW RENT	$ INCREASE	% INCREASE	$ REMAINING
ONE	2280	48.33	51.71	3.38	6.9	138.29
TWO	2311	42.94	61.19	18.25	42.5	131.39
THREE OR FOUR	2707	42.94	85.92	42.98	100	139.66
FIVE OR SIX	3051	38.13	104.61	66.48	174.3	149.64
NINE OR MORE	3582	44.77	111.25	66.48	148.4	187.25
ELDERLY	2326	47.88	50.96	3.08	6.4	142.87

TENANTS WITH INCOMES OF 21-30 PERCENT OF MEDIAN

HOUSEHOLD SIZE	GROSS INCOME	OLD RENT	NEW RENT	$ INCREASE	% INCREASE	$ REMAINING
ONE	3348	70.76	70.76	0	0	208.24
TWO	3740	73.49	82.46	8.97	12.2	229.2
THREE OR FOUR	4506	81.42	112.71	31.29	38.4	262.79
FIVE OR SIX	5308	83.95	135.76	51.81	61.7	306.57
NINE OR MORE	5914	73.92	125.73	51.81	70	367.1
ELDERLY	3314	68.25	68.25	0	0	207.91

TABLE 9

ESTIMATED IMPACT ON RENTS OF COUNTING FOOD STAMPS
AS INCOME FOR WELFARE MOTHER WITH TWO CHILDREN
USING 1982 AFDC AND FOOD STAMP GRANTS

STATE	AFDC GRANT	FOOD STAMPS	OLD RENT	NEW RENT	DOLLAR INCREASE	% INCREASE	INCOME REMAINING
ALABAMA	$118	$183	$17.68	$65.26	$47.58	269.1%	52.74
ARIZONA	202	164	39.52	82.16	42.64	107.8	119.84
ARKANSAS	122	183	18.72	66.30	47.58	254.1	55.70
CALIFORNIA	506	73	118.56	137.54	18.98	16.0	368.46
COLORADO	313	131	68.38	102.44	34.06	49.8	210.56
CONNECTICUT	427	97	98.02	123.24	25.22	25.7	303.76
DELAWARE	266	145	56.16	93.86	37.70	67.1	172.14
DIST/COL	300	135	65.00	100.10	35.10	53.9	199.9
FLORIDA	209	162	41.34	83.46	42.12	101.8	125.54
GEORGIA	183	170	34.58	78.78	44.20	127.8	104.22
IDAHO	314	131	68.64	102.70	34.06	49.6	211.30
ILLINOIS	302	134	65.52	100.36	34.84	53.1	201.64
INDIANA	255	149	53.30	92.04	38.74	72.6	162.96
IOWA	360	117	80.60	111.02	30.42	37.7	248.98
KANSAS	328	127	72.28	105.30	33.02	45.6	222.70
KENTUCKY	188	169	35.88	79.82	43.94	122.4	108.18
LOUISIANA	190	168	36.40	80.08	43.68	120.0	109.92
MAINE	301	135	65.26	100.36	35.10	53.7	200.64
MARYLAND	270	144	57.20	94.64	37.44	65.4	175.36
MASSACHUSETTS	379	111	85.54	114.4	28.86	33.7	264.60
MICHIGAN	395	107	89.70	117.52	27.82	31.0	277.48
MINNESOTA	446	91	102.96	126.62	23.66	22.9	319.38
MISSISSIPPI	96	183	11.96	59.54	47.58	397.8	36.46
MISSOURI	248	151	51.48	90.74	39.26	76.2	157.26
MONTANA	306	133	66.56	101.14	34.58	51.9	204.86
NEBRASKA	350	120	78.00	109.20	31.20	40.0	240.80
NEW HAMPSHIRE	346	121	76.96	108.42	31.46	40.8	237.58
NEW JERSEY	360	117	80.60	111.02	30.42	37.7	248.98
NEW MEXICO	248	151	51.48	90.74	39.26	76.2	157.26
NEW YORK	424	98	97.24	122.72	25.48	26.2	301.28
N. CAROLINA	192	167	36.92	80.34	43.42	117.6	111.66
N. DAKOTA	357	118	79.82	110.50	30.68	38.4	246.50

STATE	AFDC GRANT	FOOD STAMPS	OLD RENT	NEW RENT	DOLLAR INCREASE	% INCREASE	INCOME REMAINING
OHIO	$263	$146	$55.38	$ 93.34	$37.96	68.5%	$169.66
OKLAHOMA	282	140	60.32	96.72	36.4	60.3	185.28
OREGON	321	129	70.46	104.00	33.54	47.6	217.00
PENNSYLVANIA	318	130	69.68	103.48	33.8	48.5	214.52
RHODE ISLAND	453	89	104.78	127.92	23.14	22.0	325.08
S. CAROLINA	133	183	21.58	69.16	47.58	220.4	63.84
S. DAKOTA	321	129	70.46	104.00	33.54	47.6	217.00
TENNESSEE	122	183	18.72	66.30	47.58	254.1	55.70
TEXAS	118	183	17.68	65.26	47.58	269.1	52.74
UTAH	367	115	82.42	112.32	29.9	36.2	254.68
VERMONT	477	82	111.02	132.34	21.32	19.2	344.66
VIRGINIA	255	149	53.30	92.04	38.74	72.6	162.96
WASHINGTON	440	93	101.40	125.58	24.18	23.8	314.42
WEST VIRGINIA	206	163	40.56	82.94	42.38	104.4	123.06
WISCONSIN	473	83	109.98	131.56	21.58	19.6	341.44
WYOMING	315	131	68.90	102.96	34.06	49.4	212.04

SOURCE: Calculated by National Low Income Housing Coalition from information on welfare and food stamp grants contained in "Profiles of Families in Poverty: Effects of the FY 1983 Budget Proposals on the Poor" by Tom Joe, Center for the Study of Social Policy, February 1982. Rent is assumed to be 26% of income, with $300 annually deducted from income for each dependent.

membership application

return to:

national low income housing coalition
215 8th st. n.e., washington, d.c. 20002

individual membership: Regular $25; General $10; Sponsoring $100; Sustaining $500.

organizational membership: National Organization, Contributing State or Local Organization, $100; Federally Funded Organizations serving low-income people, $50; Organzations whose membership and Board are low income people, $10; Other State and Local Organizations, $25; Sponsoring Organizations, $250; Supporting Organizations, $500; Sustaining, $1,000.

enclosed is $ ____________ for a ____________ membership.

name ____________

address ____________ city ____________

state ____________ zip ____________ phone (with area code) ____________

if organizational membership representative ____________

name of U.S. Representative or congressional district ____________

coalition membership

Membership is open to all individuals and organizations who care about providing decent shelter to low-income people at a price they can afford. Extensive membership in the Coalition signals Congress and the Administration that there is broad support for decent housing. Neither organizations nor individuals are bound by specific positions of the Coalition. Membership is on a calendar basis.

individuals/state and local organizations

$25. These members pay the direct costs of providing them with all regular mailings, but they don't help much with our rent and salaries.

low income organizations/individuals

$10. These members are important to the Coalition for they show the strength of the support for decent housing, but they don't pay their own way.

national organizations/contributing state or local organizations

$100. This is a "break-even" membership, covering direct costs and a fair share of over-head.

federally funded organizations serving low-income people

$50. This is a special rate which helps us cover costs, please send more if you can.

sponsoring membership

$100. Individuals • $250. Organizations

These members pay their share and a bit more. Copies of testimony are free to them on request.

sustaining membership

$1,000. Organizations • $500. Individuals

These members are the key to our present and future survival.

Ms. DOLBEARE. I would like to thank you and the staff on both sides of the aisle for the kind of relationship we have established, the concern that we feel is very evident about the housing plight of low-income people, and the concern that the resources that are available are used wisely and well, which we share.

I want to express my very deep appreciation particularly to the staffs, as I say, on both sides of the aisle. They have been extremely responsive to our concerns. We may not always agree on particular program levels, but we feel in each case, the effort is made to try to be constructive, and I just wanted to say that on the record.

Senator LUGAR. I am sure it is reciprocated by the staff. They find you a very pleasant person to work with.

Ms. DOLBEARE. Thank you.

TARGETING RESOURCES

With regard to the colloquy with the last panel regarding the 50- and 80-percent median, the National Low-Income Housing Coalition has consistently supported targeting resources to the neediest people; however, the manner in which HUD defines the income levels has always struck me as being somewhat bizarre, because they take the median income for a family of four and apply deductions for smaller household sizes and additions for larger household sizes, so that you find that about 80 percent, I believe, of single-person renter households has income that according to HUD is 50 percent below the median, and for large households, you find people with incomes that are at the poverty level that somehow come out to be, I think, close to or above 80 percent of median.

So, it does seem to me to be appropriate, and you might want to consider some report language on this that HUD take another look at how they define those adjustments for family size, so that they are more realistic. And I have some familiarity with the New York figures, and I think that you would find that with a more realistic set of adjustments, a great many of the families, particularly those needing larger units, the last panel was concerned about, should, in fact, be eligible, if HUD used a reasonable definition of 50 percent of median.

I would like to move directly, skipping over the introductory material about housing need, to the major points and recommendations on the administration bill and the other bills which are before you for consideration, beginning really on page 2, I guess, of my written testimony.

Four major points, first of all, guide our approach, and the first three, at least, are in priority order. The first basic point, we believe, needs to be to maintain the existing low-income housing inventory in viable condition or bring it back to viable condition, not let it dribble away, be disposed of, be demolished, whatever, without additional major rent increases for tenants, because we think that tenants simply cannot afford additional rent increases, if we are going to continue serving very low-income tenants.

Second, we should not retreat from the commitments we have already made, which means that the next layer of priority should be to build the pipeline, the units that have already been approved.

Third, we are convinced, as I think you know, that we still need to maintain and expand our housing production programs and our housing assistance to low-income people, and we are open to some new approaches and are proposing some new approaches on this.

MODIFICATIONS IN SECTION 8 PROGRAM

And finally—and this is not in priority order, because it covers all of the others, we should not forget the housing needs in rural areas. We are seriously concerned about the modifications which the administration is proposing in the section 8 existing housing program. As we understand them, they would amount really to a 15- to 20-percent rent increase for tenants currently receiving section 8 existing housing certificates who are switched to the new program because of the change in the payment standard. We feel if there's going to be a rent increase, it should be a rent increase. It should not be a rent increase that is introduced through a change in definitions that may not be particularly prominent, in the manner in which the program operates.

There is some information in my testimony obtained from the President's Housing Commission about the kinds of households that have not been served through the section 8 existing program. Now we have no doubt that the administration is correct when it says, you have the new program. There will be people available to use the vouchers, but we do not think that is the appropriate test. We think the appropriate test is whether or not they meet the greatest appropriate test is whether or not they meet the greatest need.

Now there is considerable information in my testimony about the impact of counting food stamps as income in determining tenant rent. The lower the income of the household, the greater the impact of that. Rather quickly, on the edge of my table, I did a calculation when Mr. Abrams was testifying, where he said, after all, if people have food stamps, it is unfair. And I will supply the information, but there's a great range in the resources available, and food stamps do not adequately compensate for low-welfare grants. So that you find in the State of Texas, for example, that families will have available an income of maybe $5 or $6 a day in cash to spend after they pay the new rents at 30 percent of income, if you count food stamps.

Now that simply, I think, is not viable to live on. Because of that, we very strongly urge that the cap which I believe this committee was responsible for last year, of 10 percent per year on the amount of rent increases that can be imposed without change in income, just as a result of program changes, be retained, not increased to 20 percent. The 20-percent cap, because it is compounded, is really much higher, more than double the 10-percent limit. And there is a table here that shows the impact at the end of 2 years on raising the cap, but rents would increase for families with the same income level much more rapidly, if you increase that cap. And we think it is an extremely important protection which was adopted last year and should remain at 10 percent. The savings to the Federal Government through raising the cap from 10 percent to 20 percent are miniscule compared to what we see as a devastating impact on low-income households, who are already living at or below the margin for subsistence.

We urge that the proposed administration changes in multifamily property disposition and demolition of public housing, be rejected, again, because of our basic principle that we should be maintaining the present stock of housing in viable condition. We urge adequate operating and troubled project subsidies, modernization for the same reason. We would strongly oppose any effort to permit minimum rent requirements, because minimum rent requirements basically shift the burden of paying the cost of operation from the Federal subsidy to the very lowest income tenants. Those are the ones who would have the rents increased as the result of minimum rent requirements.

We urge that Federal support for low-income housing production be continued to extend the present programs or not totally wiping out present programs. We think a new vehicle should be in place first. First, a housing block grant program. The first measure which we would recommend for additional housing production would be a highly targeted housing block grant program, one which almost made it through the President's Commission on Housing, but didn't in quite this form, which would allocate funds to States and local governments to spend on providing new or rehabilitated units for families eligible for vouchers living in substandard housing.

Second, we support the kind of approach in S. 2171. We would urge that the targeting provisions be strengthened and retained, and that finally, we would urge that if the homesteading program is continued, we think it should be, we think it should be targeted for low-income people, and there should be a special set-aside for vouchers so that very low income people can benefit from that program.

Thank you very much.

Senator **Lugar**. Thank you very much, Ms. Dolbeare.

And now we have a frequent testifier over the years, Mr. Leon Weiner.

STATEMENT OF LEON WEINER, PRESIDENT, NATIONAL HOUSING CONFERENCE

Mr. **Weiner**. It is good to see you, Mr. Chairman. I will be real brief. My usual comment would be that in the interests of brevity I will read the report. In this case, I will not even do that.

My name is Leon Weiner. I am here today as president of the National Housing Conference. With me is Carl Coan, our legislative counsel and Bob Malakoff, who has joined us at the National Housing Conference after having spent a good many years working in the vineyards of this committee. We are delighted to have him on board. He has added a great deal of enlightenment to us in our work.

We have completed our 51st annual convention. The housing conference was born in 1931 in the midst of a similar housing conference, and I think the chairman knows of the discussion that we had some years ago, when Herbert Hoover, in 1931, recognized the housing crisis, called a national conference, and you get a feeling of deja vu when you go back and reread it. I would hope that we do not throw out some of the conclusions of that conference. They were worried about the existence of the thrift institutions, about the foreclosure problems that are beginning to take place, and about the question of the production of adequate housing for our American people.

I would suggest very quickly that one of the things that the President's Commission on Housing has not looked at, despite my constant nagging, is some kind of a measure of what our housing needs are in this country, and how are we dealing in meeting them. Certainly, the level of production of housing in this country during last year, and where it looks like it is going, does not indicate that we're doing an adequate job on that. I know the committee and the chairman have certainly been concerned with that. And it is very important.

Let me congratulate the chairman, Senator Garn, Senator Laxalt, Senator Hatfield, for the beautiful letter sent to the President of the United States, dated April 6. We are impressed not only with the contents of the letter, it is a perceptiveness in what the problems were. It is outlining some immediate answers that would create jobs, and so on. We are also impressed with the fact that as of this morning at 10 o'clock, you got an answer to your letter. The Secretary of HUD announced this morning some of the things that you dealt with are being put into effect. I certainly want to congratulate you and thank you for that effort.

While, incidentally, on that subject of the regulation that just came out this morning, we are much confused about some of the provisions, and I hope we can clear them up, because they want us to get all of that done before August 1. I have a suspicion it is going to take a couple of months to try to interpret what was said. First of all, obviously, we are concerned that the Senate and the House both reject the proposed rescission of funds for fiscal 1982. We think that housing is needed. It was already passed and approved in our budgets, and I think that we need to get some of that housing under way, both for the economy of the country and, frankly, equally well, because I think that there is a tremendous need out there for the housing that was involved. We support it in our convention, and we are including and hope it will be included in the record, our resolutions of our conference and of the testimony itself.

Senator **Lugar**. So ordered.

NEEDS FOR LOW- AND MODERATE-INCOME FAMILIES

Mr. **Weiner**. We support what is better known throughout the country as the Lugar bill, and we hope you will proceed with it forthwith. We did join in writing a letter to you urging that you needed to couple that with concern for the needs for low- and moderate-income families. The housing conference is concerned with housing all of the American people. We think a high priority is for the low and moderate income housing, because they have much more—much greater difficulty, but we think it is—we are remiss if we do not understand there is a real housing problem in our country. Young people are mad. They are really mad, because they are being cut off at the switches, whether they are middle income or low income, equally. There needs to be a broad-based kind of a program that deals with all of those problems.

I would have appreciated being on the panel with Mr. Phil Abrams this morning. I think the chairman might understand why I say that, because while I am a private sector developer, and I have no vested interest in public housing on a personal basis, the National Housing Conference—and I think all of us have recognized that a strong public housing program is a prerequisite in this Nation to deal with many of the problems that are facing our society. And on the whole, if you get away from a few of the horror stories of Chicago or New York or a few other places, I think we can be proud, as a Nation, of what we did through the public housing program.

I join Cushing Dolbeare in my concern of the kind of an effect that the food stamp calculation and a few other things are going to do to the public housing population. I think we have come a long way in this society not to have the county poorhouse notion. And I think, therefore, I do not agree with the 50 percent limitation.

While I think that those in greatest need certainly out to get the greatest attention, do not think we should create ghettos of poor people. And therefore, I think a point made earlier by Senator D'Amato and others, that we ought to permit an economic mix, as well as permitting various cross sections of the community to have access to housing.

I think the chairman is familiar with some of NHC's positions. We believe that there is a strong housing need. We regret that the President's commission has not made that the cardinal point of its report.

From what we have seen today, we would suggest that there is a tremendous need out there and that we have got to find a way within the constraints, fiscal and national resources, and so forth, to really give it the kind of priority it needs.

Thank you.

Senator LUGAR. Thank you very much, Mr. Weiner.

[The complete statement follows:]

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KENNETH N. HYLTON
Chairman of the Board

LEON N. WEINER
President

STATEMENT
OF
THE NATIONAL HOUSING CONFERENCE
BEFORE THE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

APRIL 15,1982

My name is Leon N. Weiner and I appear here today as President of the National Housing Conference. We appreciate this opportunity to present our views on housing legislation pending before the Subcommittee.

These hearings are being held at a time of considerable distress in the economy in general and for housing in particular. The nation is in a serious recession and housing is in a depression. In fact, the housing industry is probably in its worst condition since the 1930's, with housing starts for seven months in a row under a million units on an annualized basis, and for most of that time under 900,000 units.

At the same time we have a great pent-up demand for both ownership and rental housing, which is going unmet. Those most affected by this situation are those least able to afford it, the nation's low and moderate income families and elderly.

Construction unemployment is approaching 20%, over double that for the nation as a whole. Builders of housing of all types are going broke by the hundreds. Many families are finding it increasingly difficult to keep their mortgage payments up, as deliquencies have risen significantly in recent months.

Normally, when things turn this bad in the economy, and in housing especially, the Federal Government undertakes to resuscitate housing and through it the economy in general. Unlike past recessions since World War II, we have yet to see any such effort to remedy today's problems. The Administration so far has only proposed or undertaken actions which would further depress the housing industry.

The Administration has announced that it plans to reduce the present pipeline of approved, but uncompleted, low and moderate income housing units by 300,000 and HUD has undertaken a series of

Established 1931 to promote better communities and decent homes for all Americans

administrative actions to assure that this 300,000-unit reduction is accomplished. The very limited amount of housing assistance approved in the HUD Appropriations Act for this fiscal year would also be decimated by the Administration, which is seeking a rescission of $9.4 billion in budget authority and proposing to use over $7 billion of FY1982 budget authority to switch existing rent supplement units to the Section 8 program, whether needed or not.

The result of all this, if approved by the Congress, would be practically no addition to the supply of housing for the lower income. The Administration has also proposed practically no additional housing assistance for FY1983, but instead has indicated it will seek a further rescission. It has further announced its intention to seek substantial cutbacks in rural housing and in the basic FHA and GNMA programs.

It was in this atmosphere of retreat, from a 50-year history of affirmative Federal efforts to improve the housing of the American people, that the National Housing Conference held its 51st Annual Meeting last month. The Conference was formed in 1931 specifically to work for the achievement of the opportunity of a decent home for every American. This became a national policy in 1949 in that year's housing act and has been reaffirmed by Congress several times since. While efforts to meet that goal have had their ups and downs over the past 30 years, never have we seen such a calculated plan to withdraw from this commitment as has now been laid before the nation.

The National Housing Conference, therefore, in its resolutions adopted last week called for a recommitment from the Federal Government to an active role in housing and to meeting the housing needs of the nation. We also recognize that we are faced with a period of severe budgetary constraints, with projected deficits in the $100 billion plus range, deficits which just a few years ago would have been unimaginable, and, therefore, have structured our proposals accordingly.

The resolutions and a statement on the 1982 Housing Crisis adopted at our Annual Meeting are attached. You will note that the resolutions basically call for maintaining the very minimal level of assistance contained in the HUD and FmHA appropriations acts for this year and continuing at least that level in FY1983. These levels are far less than what is needed, but at least they represent a recognition that we must continue to endeavor to meet the housing needs of the low and the moderate income.

Our resolutions also call for the Federal Government to undertake such other actions and efforts as may be needed to assure an adequate flow of mortgage credit at affordable interest rates, so as to permit the housing industry to get up off the floor and produce the housing that Americans of all income levels unquestionably need. I will not endeavor to list each of the resolutions adopted by NHC last week. However, I should like to highlight some of their major features.

First, and most important, we urge Congress to reject the proposed rescission of funds appropriated for FY1982. Secondly, we urge the Congress to take such actions as may be necessary to permit construction to start on the tens of thousands of Section 8 and other HUD-assisted housing units, which are ready to go to construction but cannot because of a lack of affordable mortgage financing and the outrageously high interest rates now confronting housing.

If this means that additional GNMA Tandem funds must be provided, then we urge that those funds be provided now for at least all those projects which participated in the recent lottery held by GNMA and failed to be funded. This should permit construction of almost 60,000 units to get underway within two to three months of the funds being provided.

We also urge that, if HUD is unable or unwilling to make reasonable adjustments to its financing adjustment factor regulations for those Section 8 projects planning to use tax-exempt financing, Congress make those adjustments for HUD. As a minimum, the present June 1, 1982, start of construction date must be extended to at least the end of the fiscal year and an interest rate of up to 14% should be authorized for the FAF.

Congress should further direct HUD to cease its arbitrary adminstrative actions designed to kill existing Section 8 and public housing projects. These actions have taken the form of unrealistic deadlines for the commencement of construction, deadlines which do not recognize the realities of the mortgage market; of refusal to recognize real cost increases since funds were first reserved for a Section 8 project, but instead to permit only an arbitrary 7-3/4% annual cost increase; unrealistic limits on total development cost for public housing projects, applied retroactively and even of refusing to permit reserved funds to be switched from one reservation category where financing might be more feasible.

In the last situation the premise is that HUD's computer is set up so as to count the switch as a cancellation in the first category and the authorization of new units in the second category, which would be contrary to HUD's promise to OMB not to authorize any new Section 8 housing units. In other words, HUD seems dedicated to not producing housing, not to finding ways to make things work in these difficult times.

We also call in our resolutions for a continued funding of present housing programs in FY 1983 at least at the levels approved for FY 1982. We recognize that some have raised questions about the efficacy of many of the existing housing assistance programs. We also recognize that there are various proposals floating around to switch housing assistance to a voucher program or to a block grant program or to some other method which allegedly will be less costly than present methods. We sympathize with efforts to reduce, where reasonably possible, the cost of assisted housing. But, we strongly oppose stopping present programs, until new and effective repalcement programs are developed and operational.

The Adminstration's proposed housing legislation for 1982, the Housing and Community Development Amendments of 1982, S2361 unfortunately, takes this route. It proposes to abandon almost completely a forty-five year history of effort to meet the housing needs of lower income people by adding to the supply of housing available to them. We reject the Administration's legislation as totally inadequate. The limited housing voucher program that has been proposed by the Administration will not meet the housing needs of lower income Americans. Nor will the very limited rehabilitation grant program included in S2361.

A complete cessation in new construction and substantial rehabilitation of housing for the low and moderate income just does not make sense at this time of historic lows in the vacancy rate for rental housing. This is especially true in rural areas where vacant housing is usually nothing better than a shack without plumbing or other modern and necessary amenities. Therefore, we urge the Subcommittee to authorize at least the same level of housing loans and grants under the Farmers Home Administration's programs as were provided this fiscal year.

To call for a reduction in the use of FHA and GNMA programs in this time of low housing production and low housing sales just does not make sense. Instead of constraining these proven aids to the housing market, we believe that the Administration and Congress should be seeking ways to make them work more effectively and structuring special programs to increase the production of much needed housing. We, therefore, support programs which would spur the production of single-family homes and/or multifamily projects for the moderate and middle income, but not at the expense of further reducing assistance for the lower income.

In this vein we should like to address ourselves to the proposals contained in S.226, introduced by the Chairman and several other Senators, and in S. 2327 and S. 2346. Both S.226 and S.2327 would authorize large-scale asistance to purchasers of newly constructed houses, with S.2327 permitting some of its funds to be used for existing homes, in an effort to get going again mordant single-family housing construction. We support such an effort as urgently needed at this time.

S. 2171 would initiate an ongoing program to increase the supply of rental and cooperative housing. We also support such an effort and we support the concept of requiring that 20% of those units be reserved for the lower income. On the other hand, we are concerned that the low-income housing that would be provided under this program not be looked upon as a replacement for the Section 8 program, until it is known whether this new program will in fact work, and until it is functioning and actually producing housing. We have learned too often over the years that it takes a substantial time period for any new HUD program to be put in place and for HUD personnel and those who will use the program to learn how the program functions. We do not believe it is right that a working program such as Section 8 be stopped until a new program is fully underway.

We do not believe that any of these bills should go forward without being accompanied by action that will assure that the housing needs of the lower income also continue to be met. As a minimum, this means that actions, such as those proposed in S. 2346, should be approved. S. 2346 would reject the Administration's proposed receission of funds for the Section 8 and public housing programs, urge that projects with fund reservations under those programs that can start construction within 12 months be allowed to go to construction, and provide an additional authorization for GNMA Tandem Funds. We believe it would be totally unjust to authorize billions of dollars for housing the middle income at the same time that already-appropriated housing funds for the lower income were being eliminated.

In addition to programs to spur the construction of privately owned housing for the low to middle income, NHC believes that it is essential that a strong public housing program be maintained. Public housing has been the mainstay since 1937 of our society's efforts to meet the housing needs of low income families. Through it over one million housing units have been constructed or rehabilitated -- housing which today is still available and which has provided decent shelter at a reasonable cost to many millions of families who were and are in need of such shelter.

Public housing has done the job for which it was designed. That job, however, is not over, despite the talk we are hearing about tearing down projects and "privatizing" others. In many cities of the nation public housing is the only available housing for families who cannot pay today's market rents. This is particulary true for large families, and those who need supportive social services which are seldom provided in conjunction with privately-owned housing. The construction and modernization of public housing, we should remember, also provides jobs and economic activity, which are badly needed in this time of serious recession. NHC strongly supports legislative proposals which will permit continued operation and conservation of the nation's low income housing stock.

In closing, I should like to say that the National Housing Conference will continue its dedication to working for the achievement of a "decent home and a suitable living environment for every American" as called for by Congress in 1949. We urge this Subcommittee, the full Banking Committee, the Senate and the entire Congress to rededicate themselves to achieving that goal.

To help fight against the retreat from that goal that now seems to be underway, we have helped establish the Save Housing Coalition. This coalition was formed by 20 national organizations representing all aspects of housing. I have attached for your information the Coalition's statement of purpose and a list of the participating organizations. We urge you to join with us in working to preserve this nation's commitment to the goal of decent, affordable housing for all Americans.

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SAVE-HOUSING COALITION

This is no time for complacency about housing in our country.

Young families, senior citizens, the poor, and even the not-so-poor are confronted every day with rising shelter costs and a growing housing shortage. Two families doubling up in houses built-for-one is no longer uncommon. Nor is the sight of homeless people sleeping in makeshift shelters. Those who build houses are being forced into bankruptcy and unemployment. Those who make the products out of which houses are built are idled. Those who manufacture the goods that make a house a home are seeing their markets vanish. Those who find and sell houses for people have few customers. Lenders who extend mortgage credit face an uncertain future. Those who govern our cities, towns and counties contend daily with housing and neighborhood deterioration that threatens the viability of their communiites. All of us are concerned that we will need shelter in the coming decade. Our existing housing stock will not last forever; it needs to be replaced, improved and rehabilitated.

We know that our Nation's resources are not unlimited. We know that we must take steps to expand our productive efforts. We know that the Nation today must make difficult choices about how we shall use our resources.

As representatives and leaders of national organizations concerned about the general welfare of our citizens and the future of our nation, we call upon the Congress and the Administration to "get down to basics." Shelter is basic. It is a basic human need that cannot long be ignored if life and community are to be sustained. Shelter is a basic industry. It provides productive employment for millions of workers directly -- and an even greater number in allied materials, equipment and furnishings manufacturing. We believe that housing needs should not be ignored -- and that building capacity should not be wasted.

We are deeply concerned by proposals to TERMINATE EXISTING COMMITMENTS for housing; RESCIND FUNDS which have already been appropriated; RAISE RENTS in LOW-INCOME housing; CURTAIL homeownership LOANS; CUT BACK on PUBLIC HOUSING and RENTAL ASSISTANCE; and ELIMINATE housing PRODUCTION and REHAB programs. Such proposals would adversely affect the elderly and handicapped, the rural poor and lower-income urban families -- groups who have already taken more than their share of budget cuts.

We believe this nation needs and can support housing programs that will provide adequate levels of production and assistance. We call upon the Congress and the Administration to preserve this nation's commitment to the goal of decent, affordable housing for all Americans.

Contact: National Housing Conference
223-4844

Contact: NATIONAL HOUSING CONFERENCE
(202) 223-4844

SAVE HOUSING COALITION
(Participating groups)

AD HOC COALITION OF HOUSING FOR THE ELDERLY

AMERICAN FEDERATION OF LABOR/CONGRESS OF INDUSTRIAL ORGANIZATIONS
- AFL/CIO Housing Committee
- International Union of Bricklayers
- Brotherhood of Carpenters
- International Brotherhood of Electrical Workers
- International Union of Operating Engineers

AMERICAN ASSOCIATION OF HOMES FOR THE AGING

COMMITTEE AGAINST DISCRIMINATION IN HOUSING

COUNCIL OF STATE HOUSING AGENCIES

INTERRELIGIOUS COALITION FOR HOUSING

LEADERSHIP CONFERENCE ON CIVIL RIGHTS (Housing Task Force)

LEAGUE OF WOMEN VOTERS OF THE UNITED STATES

LUTHERAN HOUSING COALITION

MORTGAGE BANKERS OF AMERICA

NATIONAL ASSOCIATION OF COUNTIES

NATIONAL ASSOCIATION OF HOUSING & REDEVELOPMENT OFFICIALS

NATIONAL HOUSING CONFERENCE

NATIONAL LEAGUE OF CITIES

NATIONAL LEASED HOUSING ASSOCIATION

NATIONAL LOW-INCOME HOUSING COALITION

NATIONAL LUMBER AND BUILDING MATERIAL DEALERS ASSOCIATION

NATIONAL RURAL HOUSING COALITION
- Hispanic Housing Coalition
- Housing Assistance Council
- National Association of Farmworkers Organizations
- Rural America

NORTHEASTERN RETAIL LUMBERMAN'S ASSOCIATION

U. S. CONFERENCE OF MAYORS

Senator **Lugar**. Now, I would call upon Mr. Ross for his testimony.

STATEMENT OF TERRY C. ROSS, PRESIDENT, NATIONAL LEASED HOUSING ASSOCIATION

Mr. **Ross**. Thank you, Mr. Chairman.

My name is C. Terry Ross. I am president of Lamers & Ross Development Co. in Baytown, Tex., and president of the National Leased Housing Association.

I am accompanied by Charles L. Edson, counsel to the National Leased Housing Association.

I would request that my written testimony be included in full in the record.

Senator **Lugar**. It will be included.

[The complete statement follows:]

National
Leased
Housing
Association

serving America's
rental housing needs

1800 M STREET, NW / SUITE 400 SOUTH / WASHINGTON, D.C. 20036 / (202)785-8888

TESTIMONY OF C. TERRY ROSS, PRESIDENT
NATIONAL LEASED HOUSING ASSOCIATION
BEFORE THE HOUSING AND URBAN AFFAIRS SUBCOMMITTEE
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

April 15, 1982

My name is C. Terry Ross. I am president of Lammers & Ross Development Company, Inc., Baytown, Texas, and president of the National Leased Housing Association, on whose behalf I testify today. I am accompanied by Charles L. Edson of Lane and Edson, P.C., Counsel to the National Leased Housing Association.

Although NLHA has appeared before your Committee for many years, we are before you today in a new and broader role. In our early years, we were the advocates for the Section 23 Leased Housing Program, and since 1974, we have been solely involved in fostering a strong and workable Section 8. In recent times, however, we have broadened our concern to all rental housing, especially rental housing in which the government is involved either through assistance or insurance.

This emphasis on rental housing is most timely. In addition to traditional renter groups -- the young, the elderly and the transient -- we now have an ever-increasing group of families who just don't have the funds available to buy their own home. In addition, many others are now choosing to rent instead of buy, as it becomes apparent that home ownership in the 1980's just will not be the miraculous investment it has been in the past decade.

The Rental Housing Production and Rehabilitation Act of 1982 (S.2171)

Thus, our primary purpose here today is to urge passage of S.2171, introduced by Senators Dodd and Cranston, a measure that could produce over 100,000 badly needed rental units per year.

The need for rental production programs is clear. As pointed out in Senator Dodd's floor statement of March 4, 1982, various studies estimate an annual shortfall of multifamily units of between 170,000 and 302,000 units per year. Indeed, one study estimated an annual need of 500,000 rental units. This figure should be compared with the 45,000 rental starts in 1981 that occurred without government subsidy.

We are aware of recent studies by the Rand Corporation and the Department of Housing and Urban Development which seem to point to an opposite conclusion. In this regard, two of our members, Edward C. Carman, Jr. and David Smith of the Boston Financial Technology Group have done a thorough analysis of the HUD and Rand studies, and found them lacking in several key respects. Although we may not endorse all the conclusions of this study, we believe this study reaches some interesting conclusions, and we ask your permission to insert it in the record.

Primarily, both the Rand and HUD studies look backwards to the experience of the 1970's and try to apply it to the 1980's. Rand and HUD bottom their conclusion of no rental housing shortage on the fact that the Consumer Price Index in the 1970's rose at a faster rate than did rents -- this indicating a lack of demand. In our view, this rent lag could be explained by many other reasons, such as rent control, fear of rent control, and the reluctance on the part of small renters to raise rents for long-time tenants. In addition, the Boston Financial study indicates that the supply of rental units in the 1970's was greatly enhanced by over-building in the early part of that decade, resulting from the prevailing cheap source of loan funds to developers. As you are well aware, the day of such long-term low interest fixed rate mortgages is over. Accordingly, if the other 1970 supply source denominated in the study -- federal housing production programs -- is removed, then there will be virtually no rental housing production at a time when demographic and market factors are causing great need.

Directing our attention to the Dodd-Cranston bill, we view it as a vital new initiative if we are to begin to meet the rental housing crisis in this country. Its basic concept of submission by states and localities of projects to HUD for ultimate federal selection is a sound one, and could prove most workable. We do have specific suggestions for the improvement of this program, plus an alternative way to accomplish the same end, but we make our suggestions in an overall framework of approval and praise for this very worthy effort.

1. It should be made clear that public bodies, as well as private developers, can submit applications to serve as owners and developers under this program. Under Section 8, many PHA's became Section 8 developers in their own right, a very successful aspect of that program.

2. Under some state laws, it is ambiguous as to whether or not a public housing agency is a unit of local government. Because of this, Section 2(c) should be amended to read:

"Such assistance shall be made available by the Secretary to states, units of local government, public housing agencies or designated agencies thereof. .

3. Section 2(d) sets forth capital grants as permissible assistance. We strongly believe that any assistance, at least to a private developer, should be through a repayable second mortgage loan. Such loan should bear interest at the Treasury borrowing rate at the time of the loan. For the sake of project feasibility, the interest should not be payable annually, but should be accrued on a simple interest basis. Upon sale or refinancing, the developer would have to pay off the original amount of the loan, plus all such accrued interest.

This may be a somewhat unusual suggestion coming from an organization with over 300 private developer members, but we believe our suggestion is equitable, both to the government and the private development community.

Section 4(a)(4) of this bill does make the extent of recapture a criteria in awarding funds, but we would favor a more stringent requirement in this regard.

4. HUD should also be able to administer the program directly. In many cases, there just may not be approriate state or local agencies to which the developer could first take a proposal. In such cases,the developer should be able to negotiate directly with the HUD Area Office.

5. When there is state or local designation of developers, such jurisdictions should have published selection criteria, and a rating system to assure objectivity in the choice. Political favoritism is an always lurking possibility when dollars are involved.

6. As these are basically private projects, we see no rationale for the applicability of the Davis-Bacon Act. The GAO report by the Comptroller General to the Congress, dated April 27, 1979, states that "The Act results in unnecessary construction and administrative costs of several hundred million dollars annually. . .and has an inflationary effect on the areas covered by inaccurate wage rates and the economy as a whole."

7. It should be made clear that all local rent control ordinances customarily applicable to the project would be pre-empted. If not, the feasibility of many projects assisted under this section would be under real question. On this subject, we certainly understand the requirements set forth in Section 7(a)(3)(A), that the owner pass on to the tenants any reduction in debt service resulting from assistance provided by the Act. We urge that the Committee report state that HUD should administer this program flexibly so that it does not become a federal rent control provision under another name.

8. The new multifamily program should be made part of the United States Housing Act of 1937 in order that Section 11(b) financing could be utilized. Section 11(b) is an alternate source of tax exempt financing to Section 103 of the Internal Revenue Code, and has proven extremely useful in financing Section 8 projects. By including the proposed program in the United States Housing Act (with a technical amendment to Section 11(b) to remove any doubt that the new program would be eligible thereunder), this valuable alternative financing tool would be made available for use in this new effort.

These suggestions are directed toward making a good program better. S.2171 is one that we can happily endorse, but you may wish to explore an alternative to the front-end financing mechanism embodied therein.

During the past several months, a large number of housing organizations have met together informally to develop a multifamily housing production program with similar aims to those embodied in your bill. The major difference in the proposal is that instead of a front-end grant or loan, there would be an annual loan of part of the interest payment to bring down the interest rate to 6% or 8%, a mechanism analagous to that contained in the single family assistance legislation now before your committee. After fifteen years, these loans would have to be repaid with simple interest. Under this mechanism, for an annual contract authority of $139,000, 100,000 units could be assisted, assuming an annual interest subsidy of 4%. Under the Dodd-Cranston proposal, on the other hand, $1.3 billion would be necessary to finance from 50,000 to 100,000 units. At a time when the government is most conscious of annual outlays, you may wish to consider stretching such payments over time. Note that the alternative proposal suggests only a fifteen year payment period, rather than forty years under Section 8. A copy of this proposal is attached to this testimony.

The Pipeline

We urge you to include provisions in your bill to assure that those projects in the Section 8 pipeline are built. Many of our members have literally invested hundreds of thousands of dollars into projects, and all this could be lost if the Administration's proposed rescission of Section 8 funds is adopted -- and the pipeline is cut off. That is why an FY'83 Tandem authorization of $1.973 billion, the FY'82 amount, is so important in assuring that some of these projects are financed. Of equal importance is the inclusion in your bill of provisions authorizing Fair Market Rents to be based on interest rates up to 14%. Although HUD claims that many projects are "infeasible" and should not be built, in reality the only reason that the projects are not feasible is because of today's high interest rates. Last year, the Administration, in opposing the

Financing Adjustment Factor, gave us as its rationale the fact that its New Economic Program would result in lower interest rates by late 1981, and thus the project should not be funded at a higher rate. Now, the Administration has recognized that interest rates will not be significantly lower in 1982, so there seems to be absolutely no rationale for opposing the permanent embodiment of the Financing Adjustment Factor into law. Finally, your Committee Report should clearly instruct HUD to remove artificial restrictions now being imposed on pipeline projects, such as that limiting adjustments to contract rents to 7-3/4% annually when the developers' actual costs are far greater than that.

The Administration's Bill

Let us now turn to the Administration's bill. Our major concern is with the modified Section 8 existing housing program and its failure to include a multifamily production program. This will mark the first time since 1937 that the government has not assisted in the production of rental housing, resulting in a classic mismatch of low activity and high need. Ironically, in its section by section explanation of its bill, HUD acknowledges that "current economic conditions have made the production of multifamily rental housing difficult."

Our specific comments follow:

Modified Section 8 Existing Housing Assistance Program

NLHA has over 200 local housing authority members who administer the Section 8 existing program, so we are naturally quite concerned with its future directions. By and large, we have been quite satisfied with the program as it is now structured, and we have seen no real need for the comprehensive changes proposed in this legislation. We do have the following specific comments, however, if changes are to be made:

1. We do favor the concept of permitting the family to pay more than the now-prescribed Fair Market Rent for the unit. We believe that if a tenant does want to pay more than 30% of family income to rent a better unit, it should be allowed to do so.

2. We have great concern with the new "payment standards" replacing the present Fair Market Rents. Our concern is directed to the adequacy of the amount of payment. We are particularly disturbed by the proposal that these payment standards not be published for public comment. There would be very little protection against the arbitrary imposition of low payment standards which would, in effect, gut the program unless the public had a chance to comment and appeal.

3. It should be made clear that as under the Section 8 existing program, payments should go directly from the housing authority to the landlord, and not to the tenant. This is the only practical way to assure that the landlord receives a rent payment.

4. We have no difficulty with the minimum rent provisions to the effect that the tenant must either pay ten percent of gross income or the portion of any welfare assistance payments specifically designated to meet housing costs. However, in such event, the state should not be permitted to lower the amount of specifically designated housing payments, or else the tenant could be caught in a vicious circle of being cut by both HUD and the state welfare agency.

5. It is most unfair to set the maximum amount of assistance at the amount in effect when the tenant entered the program. This would mean that if the tenant's income went down, the family would receive no greater assistance; on the other hand, if the income went up, the assistance would be reduced. This is the classic example of "Heads I win, tails you lose."

6. The proposal would eliminate the sixty day period for the payment for vacant units. We have found this to be a very necessary provision to get landlords to enter the program; however, because of the real demand for Section 8 assistance, vacancies rarely occur and thus these payments are infrequently made. In other words, the sixty day vacancy provision provides psychological benefits to landlords without any real cost to the government.

7. We do not object to limiting assistance to families in 50% of median under this phase of the program. However, any applicant on a waiting list currently who is in the 50% to 80% of median category should be allowed to remain. If this is not done, there would be real hardships to those families who justifiably relied on the program, in addition to some real administrative problems for the local administering agency.

8. There is a conflict between extending the priority criteria to those families paying over 50% of their income for rent and the present priority for families living in substandard housing. It is the experience of many of our members that those paying over 50% of their income for housing are doing so voluntarily to get better housing. Should they be housed over those who are now living in substandard housing? This is a real question of equity.

We understand the rationale for making the certificates usable on a national basis. However, we believe this creates tremendous administrative problems, especially to the originating agency. Any agency administering the program has to have an accurate inventory of the certificates they have outstanding and the likelihood that they will be used, as this determines their ability to issue additional certificates. If a tenant can utilize a certificate from one authority in the jurisdiction of another, it would seem most difficult for the originating authority to have an accurate knowledge of how many certificates are charged against it.

can co-insure. In the multifamily field, we believe that coinsurance could be a very useful tool to enable the lender to, in effect, buy freedom from arduous processing restrictions by willingness to assume part of the risk of the loan. With the small volume of multifamily mortgages, unless the 20% restriction is removed, the co-insurance program is in danger of becoming a nullity.

Extension of Creative Financing to Multifamily Projects

We favor the amendment to Section 245(c) to allow graduated mortgages for multifamily insured projects, and also the new Section 316(b) to allow shared appreciation mortgages for such rental efforts. Although the use of these new devices is in its infancy for multifamily housing programs, certainly the opportunity should exist to utilize such creative financing with FHA multifamily insurance.

Section 8 New Construction - The Final Word

It has now become fashionable to repudiate the Section 8 new construction and substantial rehabilitation program. However, in the final analysis, the only objection that can be validly leveled against this phase of the Section 8 program is its expense. The major reason for such cost is that the program sought to house the lowest income people in the most expensive type of housing -- that which is newly constructed or substantially rehabilitated. During its eight years, Section 8 has accounted for over 750,000 units of decent housing. Unlike some of its predecessors, the program has been virtually free of charges of scandal or mismanagement. It has resulted in projects that are a credit to the communities in which they are located, and indeed, many Section 8 projects have done much for community revitalization. It can be fairly said that the only real problem with Section 8 is that it has succeeded in filling its purpose, and that the cost just became too high in this stringent economy.

Because the focus of the National Leased Housing Association is limited to rental housing, we have not addressed any of the provisions in the Administration's bill, or the bill introduced by the chairman of this subcommittee, concerning single family housing. NLHA is no way opposes efforts such as those proposed by Senator Lugar to assist the single family industry in these very difficult times; however, we are constrained to point out the following.

- The multifamily construction industry is in just as desparate straits as is the single family.
- The need for decent rental housing is equal to the need to provide opportunities for home ownership.
- The construction of rental units means just as many jobs as the construction of single family homes.

Therefore, we urge the Senate to take a comprehensive approach in meeting this nation's housing needs, with a balanced bill that contains your constructive single family initiative, the multifamily proposal of Senators Dodd and Cranston, and provisions assuring continued decent housing for low income families through completion of the pipeline projects and provision of adequate operatingand modernization subsidies for public housing projects.

Thank you for the opportunity to appear before you today.

February 5, 1982

Flexible Rental Housing Production Loan Program

Ad Hoc No Name Coalition
Eugene A. Gulledge, Chairman
Charles L. Edson, Subcommittee Chairman

Following is the final draft that has emerged from seven working sessions attended by representatives of major housing groups from October 1981 to early February, 1982.

It is doubtful that any group totally subscribes to all of the program elements set forth herein. Many issues must be resolved in the legislative process including the specific requirements of Wall Street as bond issues are structured. However, the following is a conceptual framework which drew broad consensus from most of those involved in the working session.

Program goals. The program goal is to produce 100,000 units annually of new and rehabilitated rental units of modest design for moderate income families. This goal must be considered within the entire framework of federal housing assistance. Of prime importance, it assumes the continuance of the Section 8 existing program or a similar voucher program to meet the needs of low income families. The group also viewed with importance the maintenance and modernization of our existing public housing stock to meet the needs of the over 1,300,000 families now housed in public housing and assumes the continuation of the Section 202 and Section 515 program as peculiarly addressing certain housing needs. The underlying rationale for this production program is the necessity to increase the present stock of rental housing if a voucher program, or any other program utilizing existing stock for lower income people, is to be feasible. A second underlying rationale is that state and local governments play a significant program role to assure that housing produced meets the needs of the communities in which it is located. Indeed, as set forth below, a locality could fashion an equivalent production program to meet its needs.

Basic Program Mechanisms

Interest Loan. Assistance would be in the form of a loan to pay part of the mortgage interest; this would not be a subsidy any more than any other loan is a subsidy. As a target, the government would lend an owner one-third of the market interest rate, or 4% whichever is less. However, at the discretion of the administering agencies, such loans could be for two-thirds of the market interest rate or 8%, whichever is less. However, the interest loans on the total of such projects of the administering agency could not reduce the mortgage interest rate more than an average of 6% per annum of the outstanding mortgages in this program.

The interest loans would be advanced monthly for a 15-year period. Interest on the loans would be at the average Treasury borrowing rates as set annually by the Secretary of the Treasury and would be cumulative but not compounded. The interest loans would be secured by a second mortgage on the property and may be insured by HUD with appropriate premium charges.

Projects could be financed by FHA insured loans including co-insured loans, conventional loans, and loans from state and local housing finance agencies. Projects would be eligible for tax exempt financing. Project loans would be for fifteen years but the amortization schedule would be for forty years.

The balance of the interest loan would be paid off at the end of 15 years either through a sale or refinancing of the project. The failure of an owner to effectuate such a sale or refinancing, or otherwise make such payment, would constitute a default.

Use of Loan Funds. The loan could be for either new construction or substantial rehabilitation. However, in the case of rehabilitation, there would be a limit to the extent that the funds could be used for refinancing or acquisition of the shell.

RReturn on Investment. The first 6% on equity would go to owner; for return over 6%, the owner retains 50% thereof and the other 50% is utilized to repay the interest loan.

Fund Allocation. Congress would authorize the amount of contract authority for interest loan funds annually; funds would be allocated to states on a formula basis taking into account the need for multifamily housing. In the legislative process Congress would determine whether the funds would be administered by:

A. The national office of HUD
B. The area offices of HUD
C. State or local housing agencies
D. A combination of the above ---

Agencies which did not use funds within 12 months of allocation would have these funds recaptured by HUD to use elsewhere without prejudice to the original agency; the Secretary of HUD could extend the 12 month period.

State and Local Participation. State and local funds may be used to reduce the capital cost, interest cost or operating cost of the project. In addition, the project must comply with appropriate state and local zoning and building codes. However, the project would be exempt from all state or local rent controls as well as any HUD rent limitation.

If a state agency or locality can demonstrate to the Secretary of the Department of Housing and Urban Development that another production mechanism can produce the same number of units within the locality as would be produced by the loan program outlined herein the Secretary may approve such equivalent program.

Income Limits. There would be no income limits on the project except as needed to meet state or local requirements for financing. However, 20% of the units must be rented to families below 80% of median. There could be no discrimination against any family because it is a voucher holder.

Cooperatives. Cooperatives would be eligible under the program. In financing cooperatives, a) the balance of the government interest loan would be repaid from proceeds of subsequent membership/unit sales and b) the government interest loan will rise to the market rate evenly through the 15-year period.

Provisions Applicable to HUD-FHA Insured Projects

Insurance Payment after year 15. In connection with FHA insured loans, it is anticipated that HUD would, at its sole option, be given the right to avoid an insurance claim at the end of the 15-year period, (if the mortgage is not otherwise paid off) by agreeing with the existing lender or a substitute lender to continue the loan at the then prevailing market interest rate. HUD could, in its sole discretion, agree to advance the additional interest which would be required in some circumstances over and above that which the project was able to pay from operations. Any such additional advances of interest would themselves be interest bearing at the prevailing Treasury rate (simple interest) and be added as part of the subordinate mortgage. All loans would be underwritten on the basis of sound underwriting principles based in part on the project's anticipated value in Year Fifteen and therefore its ability to meet its mortgage obligations during the term of the loan and at maturity. All interest advanced by HUD as an interest bearing loan would be repayable at the time of the sale or refinancing of the project.

Mortgage Amount. HUD would establish, using outside services, where appropriate, total replacement cost of multifamily rental units of modest design for each major market in the country and would commit to insure a first mortgage for 85% of that cost for units meeting its criteria. In the event that actual certified costs were lower than the originally established amount, the first mortgage would be reduced by one-half of the difference.

Operating Fund Reserve. HUD would recognize as a portion of the qualified development costs for any project an amount which a mortgagor may seek to establish as an operating fund. These monies could be drawn down and invested and utilized for the purpose of defraying rent obligations of those individuals at or below 80% of median who are occupying units in the project in order to meet the low income occupancy requirement of the program. While these funds would be eligible to be included as development costs, they would of course have to meet normal lender underwriting standards with respect to the project's ability to pay normal debt service requirements with respect to that portion of the loan.

Mr. Ross. Although we have appeared before your committee for many years, we are before you today on a new and broader role. In our earlier years, we were advocates for the section 23 leased housing program. And since 1974, we have been solely involved in fostering a strong and workable section 8 program.

In recent times, however, we have broadened our role to concern all rental housing, especially rental housing in which the Government is involved, either through assistance or insurance.

I am pleased to note that today's Wall Street Journal contains an article concerning the new role of the Naitonal Leased Housing Association, entitled "Old Trade Associations Don't Die, They Just Fight for New Programs."

Thus, our primary purpose here today is to urge passage of S. 2171, the Rental Housing Production and Rehabilitation Act of 1982, introduced by Senators Dodd and Cranston, a measure that could produce over 100,000 badly needed rental units per year.

The need for rental production programs is clear. As pointed out in Senator Dodd's floor statement of March 4, 1982, various studies estimate an annual shortfall of multifamily units of between 170,000 and 302,000 units per year.

Indeed, one study estimated an annual need of 500,000 rental units. This figure should be compared with the 45,000 rental starts in 1981 that occurred without Government subsidy.

We are aware of recent studies by the Rand Corp. and the Department of Housing and Urban Development which seem to point to the opposite conclusion. In this regard, two of our members, Edward C. Carman, Jr., and David Smith, of the Boston Financial

Technology Group, have done a thorough analysis of the HUD and Rand studies and found them lacking in several key respects.

Although we may not endorse all of the conclusions of this study, we believe the study reaches some interesting conclusions and we ask your permission to insert it in the record.

Senator **Lugar**. It will be inserted.

[Copy of the study referred to follows:]

March 25, 1982

HOUSING POLICY FOR THE 80's

Edward C. Carman, Jr. and
David A. Smith

I. Introduction

The housing industry is in severe difficulty. The level of housing construction is lower than for many decades. Interest rates are at all time highs. Even at these high rates, mortgage money is scarce. Rents are rising. People cannot afford to buy homes.

In the midst of this evident distress, the Reagan Administration and the Department of Housing and Urban Development claim that new programs to increase the supply of housing are unnecessary because there is no housing crisis. The cornerstone of their argument is a report issued in June, 1981 by the Rand Corporation which concludes that (a) the return to owners of multifamily real estate declined in real terms during the Seventies, and (b) "the only satisfying explanation ... is ... an excess supply of rental housing ..." (p. vi, our emphasis).

Appropriate housing policy for the Eighties will be effective only if it is based on an accurate perception of the environment in which housing is being built and operated. Our analysis of the Rand report has led us to believe that its conclusions are erroneous because of fundamental shortcomings in its methodology. The report used averages drawn from the last ten years to describe the present and proscribe for the future, it neglected to consider the impact of financing on the nature of and return to investments in the Seventies, and it ignored the ways in which real estate finance and operations are fundamentally different now, in early 1982, from the general experience from 1970 to 1980. We intend to show that Rand's conclusions are incorrect, and that, far from a state of surplus, the housing market now has a severe supply shortage.

Rand reached its conclusions by looking at the Net Operating Income (NOI) of multifamily residential properties. During the Seventies, NOI grew more slowly than the rate of inflation. From this single datum Rand concluded that the financial yield to the owner lost ground. Even within the report, however, the methodological flaws in the Rand analysis created confusion; Rand was unable to find a convincing explanation for this apparent yield loss. In the final paragraph of the report, Ira S. Lowry, its author stated:

> 'To me, the central mystery of the rental market in the Seventies is why rents have increased so slowly. The various partial explanations [offered by Rand] do not add up to a satisfying full explanation. I am skeptical whether we can design effective or efficient public policies for rental housing without a better understanding ....' (p. 53)

Our analysis indicates that there is an answer: in fact, three components. Ignored or understimated by Rand, these components, taken together, add up to a satisfying explanation of rental behavior in the Seventies:

(a) The overbuilding at the beginning of the decade which created vacancies in top-of-the-line apartments and suppressed rents across the board.

(b) The abundance in the Seventies of cheap, fixed-interest-rate financing.

(c) The emergence of subsidized housing as a major producer of new rental apartments.

There is a fourth phenomenom which will continue to play an important role in the coming decade:

(d) Demographic and social changes, many of which are a result of the baby boom generation coming of age.

To provide an analogy to illustrate the combined effect of these changes, imagine an observer watching for the first time the launch of an F-4 Phantom from an aircraft carrier. As soon as the plane leaves the deck of the carrier it begins to drop toward the ocean. As its speed increases, it quickly stabilizes and begins to climb. By the time it is one hundred feet above the level of the carrier deck, it is climbing rapidly.

Now imagine that the observer is asked to predict the plane's performance on the basis of its position after five or ten seconds of flight. If the observer simply extrapolates backwards, he will conclude that the F-4 is not very impressive; it has gained little attitude. Shortly, however, he will be stunned by its apparently inexplicable climb.

This, we think, characterizes the Rand view of rental housing in the Seventies. By focusing on the averages of rents and the CPI during the decade (rather than the rate of change), and by neglecting major factors affecting the market, the report and its conclusions significantly distort the current condition of the housing markets, and do not adequately appreciate the pressures which will force rents and housing costs up during the Eighties.

In this study we will review Rand's arguments, present the four major factors left undiscussed by Rand, and provide a revised analysis which takes these factors into consideration.

II. The Rand Study

Entitled "Rental Housing in the 1970's: Searching for the Crisis", the Rand Report was written by Ira S. Lowry under contract with HUD. It was delivered at a HUD-convened conference in November, 1980.

Below we will summarize the key points of the Rand Report. Before doing so, it is important to note that the whole of the Lowry's argument rests on several undisputed facts:

> From 1970 to 1979 the Consumer Price Index ("CPI") increased at a faster rate (117%) than either rents (103%) or Net Operating Income (43%). NOI went up more slowly because operating expenses increased faster (141%) than the CPI. (pps. v and vi).

From these central facts Lowry drew two key conclusions:

(1) "Nationally there is [note the present tense] an excess supply of rental housing." (p. v).

(2) "The profitability of rental property investments diminished significantly during the decade." (p. 37).

Lowry's argument follows these lines.

A. The Price of Rental Housing Services, 1970-1980. Lowry shows that "the real price of housing services to renters did not change substantially. (The adjusted gross rent index closely track the all-items CPI.)" (p. 16) In other words, rents kept pace with inflation. But the average consumption increased 8% -- apartments were generally larger and more attractive.

B. The Consumption of Rental Housing Services, 1970-78. "Both the quality and quantity of dwelling space occupied by renters improved substantially over the decade." (p.18)

C. The Affordability of Rental Housing Services, 1970-78. Renters devoted larger portions of their income to rent (from 21% in 1970 to 25% in 1978). The average renter was poorer (p. 23), evidently because wealthier tenants moved into other forms of housing.

D. The Home-Purchase Alternative. "Home purchase has been relatively attractive to many renters as an inflation-hedged investment." (p. 28) "1970 homebuyers invested wisely." (p. 30) Lowry showed that a homeowner who bought in 1970 had a very low true after-tax housing cost, because the resale value of his house increased quickly enough to compensate for the interim carrying cost.

E. Revenue from Rental Property. Rents rose slightly less than the increase in all consumer prices. "Thus, statistical evidence does not support the widespread belief that landlords have taken advantage of a tight market to raise rents outrageously." (p. 31)

F. Rental Operating Costs. "Operating costs ... increased 1.6 times the percentage increase in rental revenues. ... It is clearly the case that the owners of rental property have been unable to maintain revenue-cost parity." (p. 34)

G. Net Operating Return From Rental Property. "...increased by 34% during the 1970's, indicating that a fixed unit of housing service yielded about a third more cash to the landlord at the end of the decade than at the beginning, despite the fact that operating cost increased faster than revenue." (p. 35, our emphasis). "If the return is considered as pure income to the landlord, its purchasing power dropped by 37% during the decade." (p. 35). "These calculations do not rely at all on the property's actual purchase price or how and when the property was financed." (p. 35, our empahsis)

H. The Market Value of Rental Property. "Market values do seem to have fallen. Where the prospects for conversion are distant and uncertain, speculation is encouraged by the tax laws and leads to spotty increases in market prices. Where conversion is imminent, market values rise despite lagging current returns. In short, the market value of rental property seems to be guided by its prospects for nonrental use, not its yield as a rental property." (p. 40) But Lowry is unable to supply any worthwhile evidence to support these suppositions: "it is not clear whether actual transactions reflect that decline ... there are no national statistics on the market prices of rental properties or their trends over time." (p. 37)

I. Analysis. Having enumerated what he takes to be an inexplicable rent restraint, Lowry then offers three possible explanations, eventually rejecting each one and all three together as inadequate:

1. Length-of-stay discounts.
2. Rent control.
3. Consumer resistance.

Finally, he advances his theory:

4. "A rental housing surplus?" (p. 46) "If an economist were asked what circumstances in a competitive market would lead producers to sell their output at less than long-run average cost, he would immediately answer 'excess capacity.' Could that explanation apply to rental housing in the 1970's?" (p. 46)

Lowry reluctantly concludes yes: a surplus must be the answer. However, he goes on to say: "national data are not very good", "our tools for measuring these balances are suspect", "we are presently unable to assess the supply-demand balance in rental housing markets, either nationally or locally, so cannot evaluate arguments about rental housing surpluses or shortages ... we lack a coherent model of market processes that would allow us to interpret the data we have." (pp. 48-49).

Using much of the data in Lowry's report, and also information contained in an August 1981, HUD report to Congress on this subject (HUD: Rental Housing: Conditions and Outlook, August 1981) we have concluded that a model can be developed which allows a more persuasive explanation of rental housing in the 70's.

III. A Revised Model of Rental Housing in the Seventies

A. Overbuilding.

Both Lowry and HUD have stated their conclusion -- that there is surplus of housing -- in the present tense, when the data from which these conclusions are drawn covers a ten year average.

This is highly significant. No one denies that multifamily housing was significantly overbuilt during the early Seventies. This glut on the rental markets caused higher than normal vacancy rates and took several years to work off. It caused a significant amount of rent restraint, and prompted most institutional investors to avoid housing investments from 1975 until recently.

Data in the HUD report shows this overbuilding clearly. Information below and in chart form on the next page is shown to indicate the large amount of rental housing construction that took place in 1972 and 1973, and the subsequent several years of minimal construction.

DATA

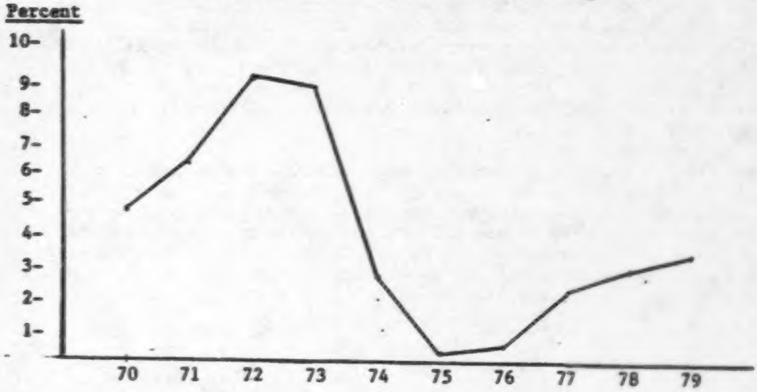
(in billions of 1972 dollars)

Year	Value of Rental Housing Stock	Change From Prior Year	Year	Value of Rental Housing Stock	Change From Pior Year
1970	195.9	4.9	1975	223.2	.3
1971	202.3	6.4	1976	223.7	.5
1972	211.4	9.1	1977	225.9	2.2
1973	220.2	8.8	1978	228.9	3.0
1974	222.9	2.7	1979	232.3	3.4

TABLE 1

Chart

Annual Increase in Value of Rental Housing Stock



HUD Report, p.7

This chart shows a situation which was disastrous to many lenders and developers during the mid-Seventies. The overbuilding caused lenders to foreclose, builders to go bankrupt, and vacancies and turnovers to run high. It showed up in national vacancy rates which went from 5.3% in 1970 to 6.3% in 1974, and then declined to 5.0% in 1980. (Lowry, p.48)

The time it took to absorb new apartments into these markets also increased substantially. According to the HUD report:

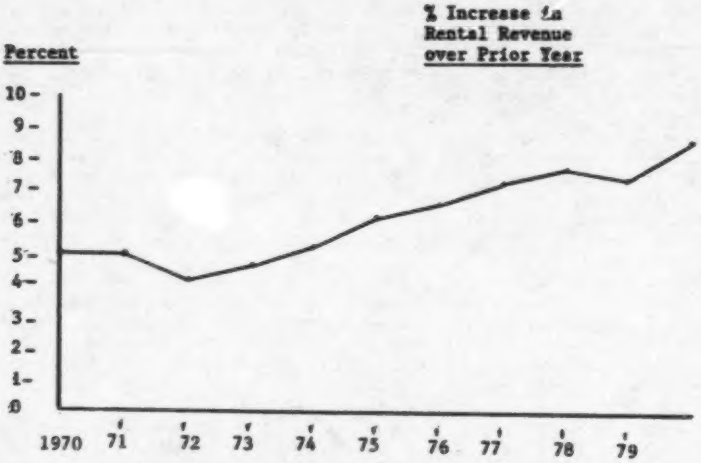
> The impact of overbuilding on rental vacancy rates is supported by the fall in the absorption rate of new units during the peak building years. Only 68 to 70 percent of new unsubsidized, unfurnished apartments were rented in the first three months during the 1972 to 1975 period. In contrast, 80 to 82 percent of such units were absorbed within three months during the years of multifamily construction (1976-1979). (p. 21)

The rate of increase of rents on a national basis also reflects the effect of overbuilding. The chart below has been derived from Lowry's information, and shows the percentage each year that rental revenues increased for a fixed amount of housing services. That rate of increase was steady at 5% during 1970 and 1971, dropped to 4.1% in 1972, and then increased each year through the end of the decade. The increase from 1979 to 1980 is the most dramatic, going from a 7.5% increase for 1978-79, to a 9.7% increase from 1979-80.

Table 2

Annual % Increase in Rental Revenues

Quality Adjusted Current $ 1967=100



DATA

	Rental Revenue	Changeover Prior Year	% Increase Over Prior Year
1967	100	-	4.0
1968	104	4.0	4.4
1969	108.6	4.6	4.4
1970	114.0	5.4	5.0
1971	120.0	6.0	5.0
1972	124.9	4.9	4.1
1973	130.9	6.0	4.8
1974	137.9	7.0	5.3
1975	146.4	8.5	6.2
1976	156.1	9.7	6.6
1977	167.6	11.5	7.4
1978	180.6	13.0	7.8
1979	194.2	13.6	7.5
1980	213.0	18.8	9.7

(Source: Rand p.56)

Without stretching our analogy too far, note the similarity of this chart, showing rates of increase in rents, to the path of our imagined F-4 leaving the deck of a carrier.

Lowry states that he is unable to find a correlation between vacancy rates and the levels of rent increases (p.49). But it scarcely seems coincidental when Vacancy Rates on a National Level go from 5.3% (1970) to 6.3% (1974) and then back to 5% (1979), a swing of nearly 20%, that the rate of increase of rents, and the amount of new construction volume should increase and decrease in exactly the same time periods. The importance of the vacancy swing is underscored when attention is focused on what type of housing suffered the most from lower average occupancy.

Almost by definition, the apartments that were overbuilt in the mid-Seventies were new apartments -- apartments built largely in suburban areas, with expectations that population increases and continued economic expansion would lead to profitability. These apartments generally would rent at the top of the rental markets. Only in unusual situations (e.g. subsidized housing; see Part C. below) would existing properties rent for more than the new units being built.

When the apartments at the top of the rental market are overbuilt, and there is a surplus of apartments, owners will keep rents low to compete for tenants. This forces less desirable properties to keep their rents low as well -- lower than the new units. This depressant on general rent levels will be felt throughout the marketplace.

As Anthony Downs has pointed out (Rand p. 41), modern multifamily apartment complexes constitute only a small percentage of the total rental market. In fact, fully 60% of all rentals are in buildings with four or less apartments. These generally older buildings are usually located in the more established centers of cities and towns. They rent for significantly less than the new, generally suburban, multifamily properties, and must follow the lead of the newer properties in setting rent levels.

Lets try to quantify the impact of overbuilding at the top of the market. In 1975, there were approximately 24 million residential rental units in the United States. Of these, only 40% (or 9,600,000) were built with five or more apartments. Assume that roughly one quarter of these apartments were relatively new in 1975, and at the top of the market. If so, only 2,400,000 apartments -- one tenth of the total -- will be effectively setting the rent levels throughout the market place.

Generally, a 5-6% vacancy factor is considered realistic and appropriate in rental properties. Ten percent vacancy is considered cause for concern, and fifteen percent is an operational disaster. Suppose for a moment that the overbuilding resulted in a 10% jump in vacancy (from 5% to 15%) in the newer and better apartment buildings. This would mean approximately 240,000 empty apartments, or 1% of the total supply. Yet this 1% will lead to rent freezes and even rollbacks among new properties, with consequent impact throughout the rest of the market. It would appear, then, that apparently small changes in the national vacancy rate can have an inordinate effect on rent levels throughout the entire rental market.

In our example, substantial overbuilding -- ten percent additional vacancy in new apartments -- shows up as only a 1% blip in nationwide vacancy statistics, yet has a disproportionate effect on rent levels for all rental properties.

It takes time to work off this excess capacity. The overbuilding occurred before 1975. Since then the number of households has increased and vacancy rates have decreased. Arguing from this historical data, as Lowry does, that an average experience during the Sevenies is an accurate description of the current rental market condition, is clearly inappropriate.

B. Cheap Financing

1. When It Was Available

HUD and Lowry have agreed that multifamily housing has been unprofitable during the Seventies, that this condition continues, and that the lack of profitablility has been a major cause of abandonment and lack of investment in new and renovated rental units. Lack of profitability is a major argument used against proposed government efforts to increase the supply of housing. Lowry states:

> Measures to increase supply will merely add to the surplus, pushing more properties into bankruptcy. (p. vii)

Similarly, HUD states that:

> New units of this type are likely to compete with the existing stock and add to the financial problems already troubling many existing projects. (p. 49)

As far as we can tell, the conclusion that housing has been unprofitable during the Seventies rests solely on Lowry data which shows that Net Operating Income increased only 34% during the Seventies, while inflation (as measured by the CPI) increased 109%. Lowry concludes that this lag in NOI has been damaging to investors in rental housing -- that their return has not kept up with inflation. This, he argues, has led to the abandonment of properties, lack of development of new properties, and the growth of conversions to condominiums.

Lowry states further that his calculations showing decreased profitability to the owner do not depend on such real estate fundamentals as the amount of the purchase price, or the amount and terms of the financing:

> ... these calculations do not rely on the property's actual purchase price or how or when the purchase was financed. Whether the purchase price was relatively high or low, whether the owner's investment is or is not highly leveraged, whether or not the owner has other income that would benefit from tax sheltering, the profitability of rental property investments diminished significantly during the decade. (p. 35)

Lowry argues that his conclusion holds whether or not the investment was leveraged. Let's put that argument to a numerical test, using Lowry's own figures and a reasonable financing assumption.

In the early Seventies most relatively new properties were bought or sold at $10,000 to $15,000 per apartment, with 80% financing at roughly 8% interest (we will use a 9% constant). This would yield the following acquisition pro-forma:

Table 3
Acquisition Pro-Forma
1970 Conventional Apartment

Purchase price	12,000
Down payment (equity)	2,000
First Mortgage	10,000
Annual debt service	900
Annual operating costs	1,000
Monthly rent	167
Annual rent	2,000
Less operating costs	(1,000)
Net Operating Income (NOI)	1,000
Debt service	(900)
Annual cash flow	100

Our hypothetical apartment buyer would be able to finance his purchase and provide himself with a 5% annual cash flow ($100 per year cash flow divided by $2,000 equity investment).

Now let's consider how our hypothetical property will be performing in 1980, using Lowry's averages: 87% rent increase, 141% operating cost increase.

Table 4
Comparison of 1970 and 1980
Hypothetical Investment

	1970	Increase over Decade	1980
Monthly Rent	167	87%	312
Annual Rent	2,000	87%	3,740
Less operating costs	(1,000)	141%	(2,410)
Net Operating Income	1,000	34%	1,330
Debt Service	(900)		(900)
Cash to Owner	100	330%.	430

The increase in NOI derived from our example -- 34% -- is consistent with the national average Lowry derived, so our hypothetical property seems to conform reasonably well to the national averages. But the owner, far from having an unprofitable investment, has quadrupled his cash flow.

Why did this result occur? Because of leverage: most of the cost was financed with other people's money. Cheap financing enabled the owner to underwrite a substantial portion of his acquisition expenditure with a fixed cost. So the owner won. Who lost?

If the overall profitability of the combined investment -- equity and debt -- declined during the decade, and if the return to the owner significantly increased, then the real after-inflation return to the mortgagee must have significantly decreased. This latter conclusion is believable, given the present state of the savings and loan institutions which were the primary source of multifamily mortgages.

Even if the owner had no financing, he may well have been satisfied with the results, compared to the alternatives. Suppose that in the above example, the owner had made the purchase with cash, paying $12,000 for the apartment unit. With no debt the $12,000 investment would have yielded an annual return of $1,000 in 1970 and $1,330 in 1980, or 8.3% at the beginning, increasing to 11.1% in 1980.

This is less attractive than the prior example -- which is why most properties were purchased with financing -- but how does it compare with putting the money in a standard savings account, or even investing in the stock market over the same period? In the savings account, the maximum by law the banks could pay until the late Seventies was 5-6%; and the value of the Standard & Poor's 500 Common Stock Index increased at only 2% per year during this period. (Real Estate Research Corpration, Emerging Trends in Real Estate: 1982. p.3). In both examples, the real estate looks relatively attractive. The buildup of net operating income also implies an increase in the residual value of the property, the mortgage principal amount was paid down, and the returns were generally tax free because of depreciation and other deductions.

These examples demonstrate that in many cases the true return to property owners during the Seventies not merely kept pace with inflation but outstripped it. The HUD report specifically addresses this conclusion:

> Calculations by de Leeuw and Ozonne indicate that there was no decline in after tax profitability between the mid-1960's and mid-1970's for typical rental housing investments. Profitability did fall relative to owner-occupied housing, but was maintained or increased relative to investment in corporate plant or equipment. (p. 27)

According to Lowry, a major result of the lack of profitability he claims existed is increased abandonment of unprofitable rental apartments. Abandonment, however, is generally understood to be a function of a variety of forces, many of which are neighborhood wide in scope, and go far beyond the control of individual investors in rental property. Once an area is perceived as unsound due to broader social conditions, the cycle of disinvestment, deterioration and abandonment sets in. At that point the general market level of rents becomes irrelevant, because the area no longer offers decent, safe living conditions.

In these situations market forces by themselves have typically been unable to effect a turnaround. Substantial public investment in utilities, streets, sidewalks and parks (and yes, even government-assisted housing), has been essential to arrest this deterioration. Because of its relatively stable market, subsidized housing is often the first project undertaken, the catalyst which spurs more ambitious developments.

A national policy which not only plans the cutback of government-assisted housing production programs but also reduces the levels of community development funds will lead to the deterioration of disadvantaged neighborhoods. Their housing stock will gradually be abandoned or taken for taxes, creating greater pressure on other markets.

2. Now That It's Gone

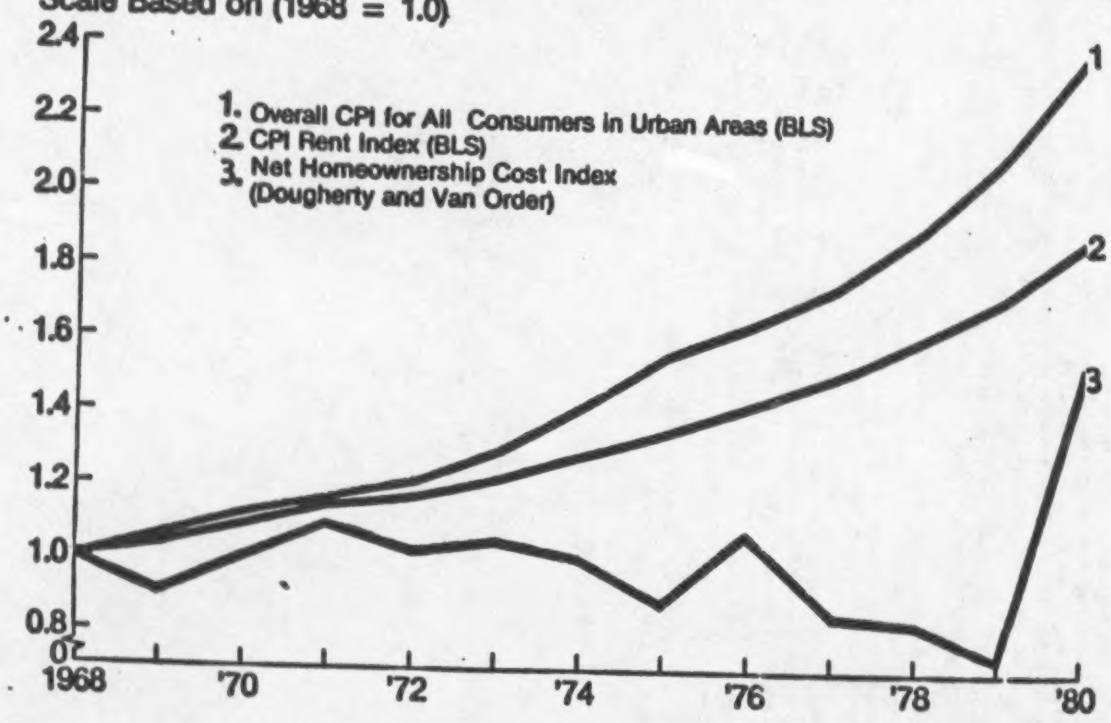
The prior section on rental housing profitability demonstrated that an apartment owner with fixed financing typically would see the cash on cash return on his investment increase much more dramatically than the 34% average increase in Net Operating Income which was the national experience during the Seventies. What will happen without this financing?

Long-term, fixed-rate cheap mortgages were generally available to home buyers (including condominium buyers) until 1979. By combining high leverage mortgages with substantial tax write-offs (interest and property taxes), and an underlying inflation rate probably exceeding the interest cost of the mortgage, home buyers could live at essentially no cost: the net sale proceeds generated by appreciation counterbalanced the low after-tax interim costs. As both HUD and Lowry point out, the result of this was a substantial shift. Renters became homeowners:

> "Between 1963 and 1979 the number of homeowners increased nearly 50 percent more than it would have in the absence of financial factors favoring home ownership." (HUD report, p. 36)

HUD has prepared a dramatic chart (see below) which shows the relative costs of the CPI, a rent index, and the net home ownership cost index. As inflation increased, and as long as traditional mortgage financing was available for homeowners, the relative price of home ownership fell. (HUD Report, p.33)

Prices, Rents and Homeownership Costs 1968–1980



The most arresting aspect of this chart is not the relative bargain home ownership represented during the Seventies, but the sharp upswing in the relative cost of home ownership in 1979. This upswing matches exactly a less pronounced but still dramatic increase in the rate of increase of rents as shown on the chart derived from Lowry's data on page 9 of this paper.

This is no coincidence as HUD explicity acknowledges. Long-term, low interest loans are no longer available to the home buyer (p.35).

But banks could only make such loans if they had a convenient source of cheap funds -- savings accounts. Savers who had put their money in savings accounts paying interest of 5 and 6 percent were the real source of the bargain prices during the Seventies for both home ownership and rentals.

Those days are over. As money has flowed out of the S&L's into the money market, mortgage rates have risen. Because the small saver has become more sophisticated, a return to the traditional type of long-term, relatively low interest rate financing seems impossible. The environment in which housing is built, operated, bought and sold has changed in its most fundamental aspects.

Again, designing national housing policy for the Eighties on an average of the experience during the Seventies makes little sense.

C. Subsidized Housing

Section 236 of The National Housing Act was passed in 1968. The Tax Reform Act of 1969 provided specific tax incentives for owners of subsidized housing. The combination of these two laws made it profitable for private developers to build and operate government assisted housing.

The business flourished in the Seventies. By the end of the decade 40% of the new multifamily production had some form of Federal involvement. What impact did this have?

All the programs were characterized by a single goal: rent reduction or restraint by means of reducing costs, by substituting tax benefits for cash return, and by including HUD regulation as a check upon rents. To achieve this goal, HUD provided the properties with various forms of assistance, either rental subsidy to tenants (to raise their ability to pay) or mortgage interest subsidy to the lender (to reduce the property's net carrying cost). In either case, the effect was the same -- subsidized properties could rent comparable apartments at a lower price, because the Federal government picked up the difference.

Usually the newest, most desirable housing carries the highest rents and establishes rent leadership. Introducing subsidized housing into existing markets reversed the traditional equation. Many government assisted properties were both more attractive and less expensive. Small wonder, then, that they rented to high occupancy very quickly.

Many of the tenants for these properties came from the worst -- the cheapest -- housing in their communities. The large number of subsidized units gave people with limited incomes, particularly the elderly, a choice of where to live, as opposed to being forced by limited resources to the upper floors of poorly heated, marginally habitable old buildings. As long as these buildings were providing needed housing for people who could afford no better, building and health inspectors were reluctant to order, even in the worst cases, extensive renovations (which would raise the rents) or condemnations.

New subsidized units all across the country shifted this balance. The worst existing housing was often no longer needed to house the most needy -- local officials and the courts were able to enforce the Health and Sanitary Codes, and many marginal buildings were consequently demolished.

The increase in the average quality of housing documented by Lowry in the Rand Report was partially a function of the demolition of the worst properties. In many cases, without the alternative new subsidized units offered, these demolitions -- and the dramatic increase in average quality -- would not have been possible.

Further because the subsidized units rented at less than market rents, they provided a significant restraint on general rent levels in the Seventies. However, as operating costs increased over the decade rent levels in many of the earlier projects -- those with interest rate subsidies -- increased dramatically.

To the extent the housing programs involved an effort to provide new housing for tenants with low incomes, the cost of the programs has become extremely high --high enough so that it has become both economically and politically unfeasible to continue the levels of subsidized construction common just a few years ago.

Thus two of the major consequences of government assisted housing production in the Seventies will be inoperable in the Eighties: the general rent restraint in the marketplace provided by these inexpensive housing alternatives will be lost, as will the option for those with limited incomes to move out of the worst housing in their communities.

D. Rethinking The Rand Report

With these undiscussed factors in mind, let's review the Rand report, to see if our theory is consistent with Rand's data:

A. Price of Housing. Rents kept pace with inflation, but, contrary to Lowry's simple analysis, owner yield improved substantially -- at the expense of lenders and savers.

B. Consumption Quality. One of the real achievements of the Seventies was the increase in quality of the general housing stock. This increase was largely a function of the replacement of older, substandard housing with new units. Measured by any fixed standard (Lowry used indoor plumbing and air conditioning as bellwethers) quality must improve. However, subsidized housing was a crucial component of this process; it provided alternative quarters for many living in the worst housing, and it thereby made condemnations and demolitions more feasible and appropriate.

C. Affordability. Renters became poorer because many of the most affluent became homeowners. This movement had the additional effect of reducing the demand for apartments, thereby helping to restrain rent increases. During the Eighties, with homeownership less a bargain, this movement may well reverse itself.

D. Home-Purchase. Owning a home during the Seventies was a real bargain, but the same individual who sold his old home for a bundle would now find, upon looking for a new house, that the bundle might not be large enough to buy anything better. In fact, the increase in values combined with the increase in interest rates has house-locked many people: if they had to buy their owner home today, at today's prices and today's interest rates they couldn't afford it.

E. Rental Revenue. Rents kept pace with inflation. Considering that they could grow more slowly than inflation and still improve the owner's yield, this conclusion suggests improvement rather than decline.

F. Operating Costs. Because of fixed-rate financing, percentage increases in operating costs could exceed percentage rent increases. As Lowry points out, this condition cannot last forever, or eventually the bottom line will begin to deteriorate. But this argues in favor of a gradual increase in the rate of rent increases until they parallel the rate expense increases.

G. Net Operating Return. We have shown in detail how including financing considerations reverses Lowry's conclusion: owners did better, not worse.

H. Market Value. Despite Lowry's statistics, prices for rental property are rising faster than a pure NOI argument would suggest. This implies that the investment market believes in increasing owner yield. On the basis of the experience of the last decade and the arguments advanced in this paper, it has reason to.

I. Analysis. The rental apartment surplus existed, but is now extinct. Ordinarily rental tightness triggers new building--but, as we will discuss, none is now on the horizon.

IV. The Next Decade

A. Increases in Rent Levels

In the introduction we identified three key causes of rent restraint: overbuilding, new subsidized housing, and cheap financing. None will exist in the Eighties. There is no longer overbuilding and a surplus, the Federal government is unable to continue past levels of subsidized construction, and favorable financing is unavailable.

What is the prognosis?

Rents will go up. Rents will go up dramatically. The questions are: How much? How fast? and, What will be the broader social and economic ramifications?

1. How Much?

Earlier in this paper we discussed the relatively large impact, in terms of rent restraint, of a seemingly small increase in the vacancy rate (5.0% to 6.3%). Conversely, as markets tighten up, relatively small increases in demand should generate substantial increases in rents. As economic, social, and demographic changes result in pressures to form new households, these households can only be accommodated by the construction of new houses or new apartments. New units will be built only if the rent levels in the general market area are high enough to support the additional debt service required.

To measure the amount by which current rents must increase to stimulate new construction given higher costs of financing, let's compare a pro forma for a new project with traditional financing with the same project being built with financing at current rates. During the Seventies financing could usually be obtained with debt service constants (the amount paid each year for principal and interest as a percent of the amount borrowed) in the range of 9-11%. Now a more realistic level is 16-18% -- almost double. In 1982, a new apartment costs $35,000 to $50,000 to build (including land, construction financing and rent-up expenses). For this example we will assume a cost of $40,000 per apartment, broken down as follows:

Table 5

Rent Increase Needed
To Support Higher Financing Cost

Cost per Apartment	$40,000
Amount of Equity (20%)	8,000
Amount of Debt (80%)	32,000
Annual per unit operating costs	$ 2,000

Item	Debt Service at 10% Constant	Debt Service at 16% Constant	Percent Increase
Operating Expenses	$2,000	$2,000	0
Debt Service	3,200	5,120	60%
Return on Equity @ 10%	800	800	0
Total Rental Income required for economic feasibility per year:	$6,000	$7,920	32%
per month:	500	660	32%

The increase in rent to make the project feasible at the new, higher debt service constant is 32% -- $1,920 per year, or $160 per month. Just the change in financing means that, other things being equal, the rent has to be 32% higher than with the traditional mortgage.

This 32% result is consistent with other estimates. For instance, Lowry states:

> Some industry spokesmen have said that market rents would have to rise by 25 to 30 percent to attract much new capital into rental housing investments. (p.11)

2. How Fast?

To make new construction feasible in the current financial environment, rents must rise 25-40% in real terms. This increase will be in addition to general inflation. Over a three year period, inflation even at 8%, would equal 25%. Thus, it is not only believable, but probable, that in many parts of the country rents will rise by 50% in the next three to five years in order to stimulate the construction of needed new housing units.

The extent to which rents will increase each year will depend on the interaction of a variety of forces, many of which will be unique to each particular area of the country. Ultimately the question becomes one of demand for additional housing units. The demand, in turn, will be related to the performance of the economy, and the willingness and financial ability of men and women to form new households. Under financial pressure people may change their past habits with regard to the rate of new household formation.

Nevertheless, it is clear that in order for new housing to be built in any quantity, rents will have to be increased significantly above their present levels. The next section discusses a number of the demographic and social changes which are occuring which appear to mean that these higher rents can be expected in the next three to five years.

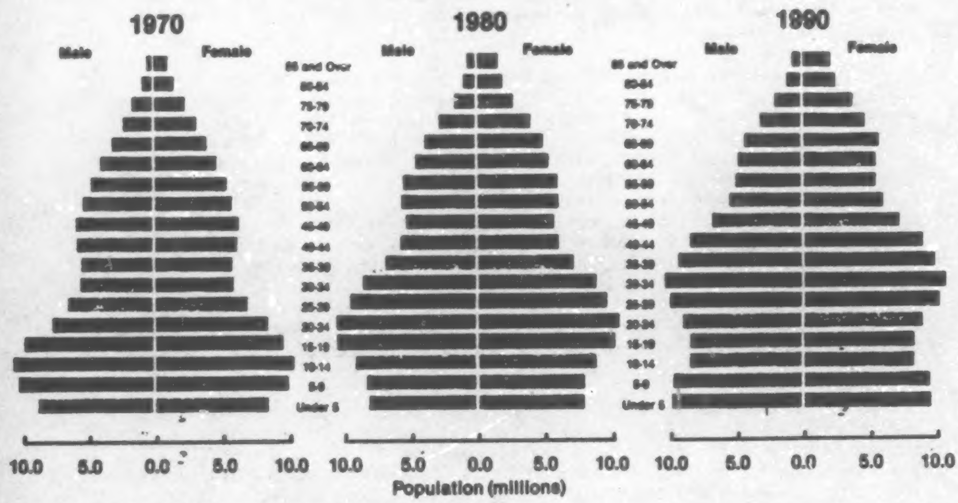
B. A Nationwide Increase in Demand

A review of projected population and household changes, plus the rate of demolitions and removals, indicates a substantial, ongoing increase in demand during the 1980's.

The last of the baby boom children will reach age 20 by 1985, and age 25 by 1990. Over the next ten years most of this age group will leave home and set up independent households. As the chart below shows (from RERC, 1981, p. 16), the number of children born in each five-year segment from 1950 to 1965 was significantly larger than the number born in prior years or subsequently. Not only the housing market, but also the economy have had to made substantial adjustments to absorb these new young adults.

The bulge in the charts represents the large number of children born between 1950 and 1965. In each of the three five year periods from 1965 to 1980, the number of children born has actually diminished. During the Eighties the number of children is projected to increase again, not because of an increase in fertility rates, but as a result of the increased number of women of childbearing age.

POPULATION AGE/SEX PYRAMIDS



Sources: 1970: U.S. Census Bureau, 1970 Census of Population and Housing
1980, 1990: U.S. Census Bureau, Current Population Reports, Series P-25

During the Eighties, the bulge moves from the 15 to 34 age group to the 25 to 44 group, graphically illustrating the demographic changes. Many of the young men and women who are now 15 to 20 will be forming households and needing additional housing.

In addition to the final coming of age of the baby boom cohort, other sociological trends are increasing the rate of household formation. Divorces, later marriages, later children, fewer children, and increased longevity for the elderly -- all have contributed to a smaller average household.

One of the best projections of household formation for the Eighties is contained in the 1980 study entitled "The Nation's Families" by George Masnick and Mary Jo Bane of The Joint Center for Urban Studies of MIT and Harvard University. Their methodology follows the patterns and choices of different age cohorts through their individual life cycles. They project an increase in the number of households for the 1980's of 13.6 million. Of this amount, 10.4 million will have no children, 2.1 million will have one child, and only 1.1 million will have two or more children.

Eleven out of twelve new households will require living accommodations of two bedrooms or smaller.

These new households will represent a net increase in demand to which the housing markets will have to respond during the next ten years. Because the increase is concentrated in small households, rental apartments (or condominiums) will provide adequate and appropriate living quarters for most of this increase.

Earlier we suggested that the upper limit on rents will be those charged for new construction in a particular area. When rents reach the level needed to make new, conventionally financed apartments profitable, it is reasonable to assume that the new units will be built. Thus, regardless of the absolute amount of growth, if the number of households increases enough to push existing rents to a level which will stimulate new construction, then the general rent levels will be at their upper limit. New construction will only occur if the market is tight enough to make it feasible. What will differ among the regions of the country which require new housing units will not be the general rent levels throughout the market, but the amount of new housing that is built.

Will the pressures on rents vary dramatically from region to region, or can one expect that there will be a similarity and consistency across the country?

In 1981 the Joint Center for Urban Affairs published an outlook report entitled Regional Diversity. It contains estimates of regional growth for the 1980's and supplies a detailed analysis of the factors affecting population growth in each of nine regions of the country, including migration, fertility, economic and demographic changes. The report predicts significant growth in population in seven of the nine regions, with only the East North Central (Ohio, Wisconsin, Illinois, and Indiana) and the Middle Atlantic (New York, Pennsylvania, and New Jersey) regions actually loosing population during the decade. A summary of their growth projections follows:

TABLE 6

Projected Population Growth, 1980-1990

Region	Population Growth Percent	(In Thousands)
New England	7.3	901
East North Central	-0.4	-166
West North Central	10.6	1,821
Mid Atlantic	-7.6	-2,795
South Atlantic	9.6	3,547
East South Central	24.5	3,593
West South Central	25.3	6,007
Mountain	31.9	3,627
Pacific	16.4	5,215
TOTAL	9.6	21,750

New England, for instance, is the third lowest in growth for the decade, but it is, nevertheless, projected to increase its population by 7.3% or nearly one million people.

However, from the point of view of housing demand, the issue is not the increase in population, but the increase in the number of households. Average household size across the nation is expected to continue its decline. Consequently the increase in population of 21,250,000 should be paralleled by an overall increase in households of 13,605,000 (The Nation's Families p.56). This will occur even in those regions where the population declines. In fact, partly because of the overall negative factors acting on these regions, the trend to smaller household size may be more pronounced than in the more prosperous areas. As the report says:

> The major change in household structure we project for the New England, Mid-Atlantic, and East North Central regions is increased single headship. (p. 129)

Further, the report specifically addresses the question of increasing households in the two declining regions, and says:

> Household sizes are shrinking, and therefore the number of households is rising in these regions [those which have declining populations] as it is across the country. (p. 43)

On a national basis, then, housing policy should anticipate an increase in demand throughout the decade, and across the country. Additional housing will be needed almost everywhere, and therefore, the upward pressure on rents will be wide-spread.

Losses from the housing stock have been averaging 500,000 to 700,000 per year (RERC, 1982, p. 13). These losses are typically properties which are the oldest: they are generally located in older, industrialized regions of the country. Consequently, in regions where the population may be dropping, there will be a disproportionate share of these losses, adding to the pressure for new housing units. If one adds the additional households which are expected to be formed (13.6 million) to the anticipated removals (6 million), the total national need for the decade is 20 million.

Twenty million required new units is on the low side of estimates that are typically made; for instance, the Home Builders Association projects demand for more than 20 million new housing units (NAHB, p.3). The Nation's Housing estimated that from 1975 to 1985 approximately 21.4 million new units would be needed (p. 62). Real Estate Research, in its report for the First Chicago Corporation, stated that if past trends were continued, they would estimate a demand over the next ten years of 20 to 23 million new housing units (p.12).

The number of new dwelling units needed to house the increased population is approximately 1.5 times the increase in households, a relationship which has generally held true over the last thirty years. For instance, from 1950 to 1970 the ratio of new units built to the increase in the number of households was 1.5 to 1 (The Nation's Housing, 1975-1985, p.62). If the historical relationship holds, the country is in need of 20,000,000 new units: two million a year.

During the Seventies, production averaged 1.8 million housing units per year; yet since 1979 production has averaged less than 1.2 million, significantly less than both the historic and the projected demand would seem to require.

Consequently, what little slack existed in the market as a result of the previous overbuilding has been and will be progressively whittled away by the shortfall in production during the last several years.

What has happened, and what will happen even more dramatically over the next few years, is that by necessity people's housing expectations will be lowered. What was commonplace yesterday may be unaffordable tomorrow. Many tenants will be forced to double up, and the stock of existing housing will be used more intensively.

Real Estate Research Corporation has estimated that the doubling-up process could reduce demand by 5 million or so over the next ten years (p. 13). This would reduce the need from 20 to 15 million new housing units (1.5 million per year). This is one way in which lifestyles will change to meet the shortfall in production. These changes will not be done easily or voluntarily, but will be forced as a result of dramatically higher rents and higher costs of home ownership.

Further, the 1.5 million new units which must be added to the supply each year will be (a) expensive, (b) smaller than in the past, and (c) below the previous expectations of tenants or homeowners, expectations formed from experience during the last twenty years. Real Estate Research points out that fewer people will be able to afford home ownership, and that a larger percentage of the population will consequently be renters:

> The radical adjustment facing consumers will be long ... and ... difficult. Potential homebuyers must come to grips with the prospects of both mortgage payments pegged to inflation or money market rates, and substantially reduced housing size. Together, these new realities will diminish the appeal of homeownership. In fact, RERC foresees a decline in the percentage of households owning their own housing by the end of the decade -- the first such reversal since the 1930's. (p.11)

In short, homes are becoming less affordable. Rents are going up. Construction is practically at a standstill. Housing will certainly be a significant domestic political issue of the Eighties.

V Conclusion

In the introduction of this paper, we suggested that the condition of the rental housing market during the seventies could be compared with the flight of an F-4 jet as it is launched from an aircraft carrier. Following its launch, it drops slightly, then accelerates, and begins to increase dramatically its angle of climb. The rate of increase in multifamily rental housing rents was level during 1970-71, dropped in 1972-73, and then has increased each year thereafter.

Rental housing during the Seventies was dramatically affected by the overbuilding which took place during 1972 through 1974. This overbuilding led to rent restraint and to substantial increases in the national vacancy rate in 1974 and 1975. Rental apartment construction was minimal for several years after the overbuilding. It regained modest levels from 1977 to 1980, but since then has been dramatically suppressed by high financing costs.

In view of the unique circumstances of the Seventies, the present condition of the housing market will bear little resemblance to the historical averages: they are not a sound basis from which to project the future.

Yet this is precisely the analytical approach taken by Ira Lowry in a report for the Rand Corporation prepared during 1980. HUD and the Reagan Administration are using this report as a basis for opposition to a proposed program to increase the supply of rental housing through a shallow subsidy approach.

Lowry states that rental property ownership has been unprofitable during the decade. We have shown that conclusion false. Lowry attributes this supposed decline in profitability to oversupply. We have shown that oversupply is a thing of the past. Lowry argues that proposed production programs would compete with current owners and exacerbate their problems with low net operating returns. We emphatically disagree.

Rent restraint during the Seventies can be explained far more persuasively by considering three factors absent from the Rand report:

(1) the overbuilding which took place between 1972 and 1974;

(2) the existence during the decade of long-term low interest fixed mortgages for both the purchase of homes and the ownership of multi-family apartments; and

(3) the significant injection of government assisted housing that was built.

These three factors made it possible for housing owners to make increasing profit even though rents went up more slowly than inflation. The interplay of these factors made it possible for the housing industry to increase the supply of housing to meet the demographic and market needs of the American people and to improve its quality. In the Eighties, demographic and social changes will not ease the crunch, but exacerbate it.

The current condition of the housing market in the United States is not characterized by surplus and lack of profitability for owners. Rather it is marked by shortages, record low vacancy rates, and the lack of affordable financing mechanisms to allow the housing industry to meet current and projected demand.

On top of this already tight market, demographic and market factors will combine during the Eighties to continue the demand for additional housing units in nearly all parts of the country. This demand can only be met by the construction of new apartment units or houses. Not only will this construction be more expensive to build, it will also carry financing costs which are 50% to 60% higher than those typical during the Seventies. To support new construction, rents will have to be 25% to 30% higher in real terms than during the Seventies.

All parts of the country, even those areas suffering minimal or negative population growth, will see a demand for new housing units during the Eighties. The issue in most communities will not be whether new units are needed, but how many. Upward pressure on general rent levels will be quite high. Only when existing rents are high enough to make new construction feasible will new apartments be built, so the squeeze will continue until rents cross this gap.

Most people will be unable to afford home ownership at the new, higher mortgage interest rates. Many will be forced to remain in rental housing much longer than typically was the case during the Sixties and Seventies. People will pay a much larger share of their income for their housing requirements. People will find that they have less disposal income available -- to set aside for savings, or to make other expenditures on which the Administration is counting to fuel economic vitality. Increased rental and homeownership costs during the Eighties may absorb a large portion of the funds made available by the reduced taxes which are the cornerstone of the Administration's supply-side economic theories.

In many communities the increased rents will generate renewed pressure for rent control. Such pressures will be highly counter-productive in terms of dealing with the problem of providing housing at reasonable cost. Rent control will build no new housing.

Those who own existing properties in relatively good condition, with fixed favorable financing in place, will see their return on investment increase dramatically during the Eighties. Those who own or live in marginal properties may well see the average condition of these properties deteriorate -- or be forced to sell -- during the next ten years because it will be increasingly difficult to obtain financing to make improvements.

Unless and until new construction recommences on a national scale, the significant increase in housing quality and availability which has been the centerpiece of the rental and home ownership market for the last twenty years may well be be reversed during the Eighties.

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Mr. Ross. The Rand and HUD studies look backward to the experience of the 1970's and try to apply it to the 1980's. Rand and HUD bottomed their conclusion of no rental housing shortage on the fact that the Consumer Price Index in the 1970's rose at a faster rate than rents, thus indicating a lack of demand.

In our view, this rent lag could be explained by many other reasons, such as rent control, a fear of rent control, reluctance on the part of small renters to raise the rent of long-term tenants.

In addition, the Boston Financial Study indicates that the supply of rental units in the 1970's was greatly enhanced by overbuilding in the early part of that decade, resulting from the prevailing cheap source of loan funds to developers.

As you are well aware, the day of such long-term, low-interest-rate mortgages is over. Accordingly, if the other 1970 supply source mentioned in the study, Federal housing production programs, is removed, then there will be virtually no rental housing production at a time when demographic and market factors are causing great need.

Directing our attention to the Dodd-Cranston bill, we view it as a vital new initiative if we are to begin to meet the rental housing crisis in this country. Its basic concept of submission by States and localities of projects to HUD for ultimate Federal selection is a sound one, and it could prove most workable.

Our prepared testimony has specific suggestions for the improvement of the program, which we invite you to consider, directed toward making a good program better.

FRONT-END FINANCING

S. 2171 is one that we can happily endorse. But you may wish to explore an alternative to the front-end financing mechanism embodied therein.

During the past several months, a large number of housing organizations met together to develop a multifamily housing production program. Under this proposal, instead of a front-end grant or loan, there would be an annual loan, a part of the interest payment to bring down the interest rate to 6 or 8 percent, a mechanism analogous to that contained in the single-family assistance legislation now before your committee.

After 15 years, these loans would have to be repaid with simple interest. Under this mechanism, for an annual contract authority of $139 million, 100,000 units could be assisted, assuming an annual interest subsidy of 4 percent under the Dodd-Cranston proposal.

On the other hand, $1.3 billion would be necessary to finance 50 to 100,000 units. At a time when the Government is most conscious of outlays, you may wish to consider stretching such payments over time, not that the alternative proposal suggests only a 15-year payment period, rather than the 40 years under section 8. A copy of this proposal is attached to our written testimony.

I wish to commend you, along with Leon, on your letter of April 6, to the President and the fast response that it got from HUD, as announced in their press conference today.

But we do urge you to include provisions in your bill to insure that those projects in the Section 8 pipeline are built.

Many of our members have invested literally hundreds of thousands of dollars into projects, and all of this would be lost if the administration's proposed rescission of section 8 fundings is adopted and the pipeline is cut off.

That is why a fiscal year 1983 tandem authorization of $1.973 billion, the fiscal year 1982 amount, is so important in assuring that some of these projects are financed.

Finally, your committee report should clearly instruct HUD to remove artificial restrictions now being imposed on pipeline projects, such as that limiting adjustments to contracts rents to 7¾ percent annually, when the developer's costs are far greater than that.

MODIFIED SECTION 8

Let us now turn to the administration's bill, with major concern—directed to the modified section 8 existing housing program. We do favor its concept of permitting the family to pay more than the now-prescribed fair market rent for the unit. We believe that if a tenant wants to pay more than 30 percent of family income to rent a better unit, it should be allowed to do so.

However, we have great concern with the new payment standards replacing the present fair market rents. Our concern is directed to the adequacy of the payment. We are particularly disturbed by the proposal that these payments standards not be published for public comment. There would be little protection against the arbitrary imposition of low payment standards, which would, in effect, gut the program unless the public had a chance to comment and appeal.

Our prepared testimony sets forth in full our concerns with the modified certificate program.

We do endorse some provisions in the administration's bill that can prove helpful to rental housing. NLHA applauds the rehabilitation program, but we do address, in our written testimony, three major concerns for possible improvements in the program.

However, until the new program has become proven, we urge the retention of the section 312 program.

We favor the administration's initiative in removing the language in section 207, mandating the Secretary regulate project rents, coupled with the administration's intent to deregulate project rent levels on an unsubsidized project. We totally agree with the rationale that such deregulation would give a needed boost to the hard-pressed rental housing industry and remove unnecessary Federal regulation.

We also support increased mortgage limits for substantial rehabilitation, removal of restrictions on FHA coinsurance, and extension of creative financing to multifamily projects.

Because the focus of the National Leased Housing Association is limited to rental housing, we have not addressed any proposed legislation concerning single-family housing.

NHLA in no way opposes efforts such as those proposed by Senator Lugar to assist the single-family industry in these very difficult times. However, we are constrained to point out the following:

The multi-family construction industry is in just as desperate straits as is the single-family. The need for decent rental housing is equal to the need to provide opportunities for homeownership.

The construction of rental units means just as many jobs as construction of single-family homes. And as your fine letter to the President emphasized, multifamily construction means jobs now.

Therefore, we urge the Senate to take a comprehensive approach in meeting this Nation's housing needs with a balanced bill that contains your constructive single-family initiative, the multifamily proposal of Senators Dodd and Cranston, and provisions assuring continued decent housing for low-income families through completion of the pipeline projects and provision of adequate operating and modernization subsidies for public housing projects.

Thank you for the opportunity to appear before you today.

Senator LUGAR. Thank you very much, Mr. Ross. I appreciate your final comments.

I simply want to reiterate, as I did at the beginning of these hearings, that I think most members of this subcommittee have a very strong feeling about the need for low-income housing. You have made that point explicit.

I would want to also—in terms of my own commitment, take advantage of the expertise that is gathered to explore two broad concepts. Each of you has testified on these points now and before.

Clearly, the debate over the 50 percent guideline that we had last year came about because of a feeling that a great number of people who qualify for low-income housing are not being served presently. That has been one of your points for many years. It comes through loud and clear, whether it is one out of 8, one of 10, one out of 12.

Many have almost commented that it becomes a lottery system of being in the right place at the right time to be served. So, logically some have said if this is the case, then clearly the benefits, since they are not reaching very many people, ought to reach the most needy.

This led then to a thought that 50 percent is an arbitrary figure, as well as any. I suppose, if you were to follow this to the extreme, you would say the most needy might be those at 10 or 20 percent of the median. And of course, there was some feathering together of the 50 and 80 percent concepts in the conference report.

There has been a movement in that direction, which you have addressed today. The administration of projects that have low income people, each manager who has testified before this committee, either this round or before, has pointed to the difficulties of this, the expenses, the fact that a mixed community is not possible or as possible under these circumstances.

Ms. Dolbeare has added an intriguing point this morning, that 50 percent itself taken from this four-member family leads to some distortion, and all families are not the conventional four or whatever might have been set up. So you may have some skewing on the basis of the numbers of members of the family or age, and so forth.

What is your general judgment as to where we ought to be heading philosophically on this point of serving the most needy? What are the just deserts in this, and at the same time attempting to meet the point that I think all three of you have made in one form or another, that an arbitrary hewing to the 50-percent standard is less desirable.

LONG-RANGE VIEW

Ms. DOLBEARE. If I could lead off, Senator. Our long-range view is that decent housing is a human right, and that everyone who needs housing assistance to get decent affordable housing ought ultimately to be provided with that assistance or the means of getting enough income through employment or whatever, so that they do not need assistance. The immediate question is what we do now. The President's Commission on Housing has pointed out there are ¼ million renter households with incomes below 50 percent of median, that at most, one out of four of each of those households is now living in assisted housing.

I think there are two ways of approaching it. First, as I said, is to suggest that HUD use a better method of adjusting. They do make some adjustments, but they make a flat deduction from income. So as I said earlier, it is skewed. I think that ought to be looked at more carefully.

Second, I think it is critical to apply these limits as they are now applied only to admission. I think that you find that if you could admit everybody as low income, you have some changes. In 1974 public housing law was changed to eliminate the requirement that housing authorities evict their over-income tenants. It meant that you did get an income mix, but you were still admitting people with the greatest needs.

Now we tend to think, and we have mentioned this in our block grant proposal on the targeting that, in addition, to saying income below 15 percent of median, since you still have 7 million eligible households, there should be the existence of some other housing problem, either that the household is living in substandard housing or is displaced, or has to pay more than 50 percent of income for rent. So that clearly they are not really able to pay their rent very regularly. Now in terms of the income mix in projects, it seems to me there is another way of looking at it. Rather than raising the income limit to 80 percent or whatever, you can subsidize only a portion of the projects or you can separate the deep subsidy that goes to the very low income people with some kinds of shallower subsidies for financing, so that by saying that we want to limit low income housing programs to people with below 50 percent of median, that does not mean that the coalition does not recognize that there may be some need for production-oriented subsidies or access to financing or insurance that would serve a broader range.

It does not mean that we want to see large projects serving exclusively very low income families. It's just that we think that the deep subsidies, that they are the only means available for assisting very low income families or low income families should, in fact, be directed to those families.

Mr. **WEINER**. I would like to wear two hats, if I can, Senator, dealing with the subject. One is my private hat. I am not talking theory now or abstractions. I administer, I own and operate low-income section 8 family projects. I got to tell you, I have a very serious doubt in my mind about whether I want to build another one, assuming the program at least has some life for a short period of time, which is limited to 50 percent or lower income, simply because from hard, practical experience, I get a concentration of the very poorest of the poor in that group. I am saying to the community where I have to get my zoning, and you understanding, having been a mayor, what is involved, that I have got to say to the community, "Nobody is going to live in this new housing, unless they are 50 percent or less," and they say, "All you're going to do is concentrate all of the poor."

One of my most effective arguments in getting a piece of land zoned is that this has a broad range—not broad enough, I think it ought to be at 90, frankly—in order to reach the kind of mix that is critically important in our society, in our cities, in our communities, and elsewhere. I just came from a zoning hearing in a rural community where with the Farmers Home Administration, where the real problem was that somebody had spread the story that I was limiting that program to people of 50 percent or less of the median income, and they began to drag out the kinds of people they were. They got very abusive. We may end up with a civil rights case, before it is over, but our contention is that there is a great need, but we need to go across-the-board, in terms of the final product of making sure that those of low income have the ability to live together and develop the upward mobility, which is a critical question throughout our housing. We have had good experiences with it. When they changed the public housing policy and did not throw them out the minute they went up to the income limit, we saw an improvement in many of the public housing projects that we have seen. Certainly, amongst the elderly this has been a very important factor.

PUBLIC INTEREST POINT OF VIEW

Now from a broad public interest point of view, I can take the position that 50 percent is too high, that really with the 50 percent, the kind of funding that we are able to allocate to this resource at this moment, it ought to be 10, maybe 20 percent. If we are really talking about those most in need, then we have to go to that kind of criteria. I think the 50 percent, which is arbitrary, maybe the 80 percent is arbitrary, but I think that as we come down, we get into a very difficult local community problem, and the ability to produce that housing and blend it into the environment, the community, becomes tougher and tougher to accomplish.

Senator **LUGAR**. Mr. Ross, do you have any thoughts on this?

Mr. **ROSS**. Yes; our primary concern, Senator, is in the retroactive aspects of the 50 percent. We have already gone into the communities and sold the community on a project for low- and moderate-income housing, a project which can have people living there, residents who have up to 80 percent of the median income of the area. We have sold the financial institutions on a project that has residents up to 80 percent of the median income of the area. We have borrowed money from them. We have sold equity partnerships to people who have put money into the projects that made them viable projects, based upon the socioeconomic mix.

Where we run into a problem is that today we are backing away from that. Now we are limited to 50 percent.

Chuck, do you have any additions?

Mr. **Edson**. I would like to say from a legal point of view, we tried to convince the conferees last year, to no avail, that it was really retroactive legislation, that you're abrogating a contract that said you can rent freely to those at the 80 percent level. What you did last year was say, "Oh, no, you can't. Only 10 percent can be up to 80 percent for existing projects and only 5 percent for those not under contract." Unfortunately, the Federal Constitution does not prohibit Congress from abrogating contracts, only the States. I did not believe my law clerk when he came up with that conclusion, so I finally had to read the Constitution, and that is really true. That is how you were able to do what you did, but it was a very unwise policy, because the communities that Leon and Terry sold the projects to, feel there was a real breach of faith.

Ms. **Dolbeare**. There is another possible way of approaching it. This is a personal suggestion. The coalition has not endorsed it, but it is something that we have talked about over the years, inconclusively. That is, if you assume, start with the premise that very low income people can afford to pay less rent than slightly higher income people, as a proportion of their income, even—I would not want to, but I could afford to pay 50 percent of my income for housing, and I could still feed myself and my family—if we based the tenant contribution inversely on incomes, let's say that people with incomes below 10 percent of median pay 10 percent of their income. Then, as your income rose, you paid a slightly higher percentage, you would not need to have income limits at all, because at some point, people's percentage would intersect with the payment standard or actual rent, and they would not get a subsidy, and then you would get out of this whole box of who's going to be eligible.

It might be harder for some project sponsors to persuade people to move in, if they were, say, at one-third, 33 percent, the 33 percent are paying 33 percent, but you would have a solution to the eligibility and mix problem, and it might be a very different approach, which might work better.

I just throw that out as a comment.

Mr. **Weiner**. A possible alternative. When I went to London to visit the housing councils where they have no means test, they try to apply this rental scale. They have got a lot of other problems. I think what we are really saying is why we have different points of view on the question. I am not sure you can say a—and say 40, 50 or whatever. The old 235 program in housing was stepped up. The higher the income, the less subsidy you got. I think there is some merit to that.

I would like to make one point. I have it in here, but I would like to stress the one thing—and I got it quickly. I could not read it all until just now—the one thing that came out in this morning's announcement in response to your letter dealt with the fact, the financial adjustment factor, and they are talking about floating half a percent under the bond rate. I guess the implication is that both of us with financial commitments will pay the other half of a percent, which would be roughly 4 or 5 percent of the mortgage, at which point, I may go to chapter 11, but that's another question.

The thing that it did not address is the importance of the GNMA and all of those projects that got shut out, certainly in the House and in the Senate, and my colleague over here talked about fiscal year 1983, and I said to him, "You really mean fiscal year 1982 supplemental, don't you?" I think that——

Mr. **Edson**. I think we need both.

Mr. **Weiner**. Fine, but the one thing that is critical is those people who got shut out at the windows with a whole series of projects. Part of them are targeted, part of them, a good many of them are the 20 percent where we were trying to get an income mix, if you remember, and which got shut out at the window, because it got left to the lost category. So I certainly would urge that the committee think about authorization. I know it has been before you, and you have thought about it, and so on, but I would like to urge that as well.

TERMINATING ITEMS IN THE PIPELINE

Senator **Lugar**. Let me ask one final question. You have been very patient to last this long through your lunch hour and into the afternoon. Let me ask, as we talk about the pipeline question, clearly all of you have favored proceeding with what is in the pipeline, and there is much support for that. The reason why the administration has proposed terminating items in the pipeline is to save money. The budget constraints seem to dictate that that is the way it should be. I do not know what we are taking a look at in terms of some conferences that may occur elsewhere in this town day by day, and finally come up with a figure, a ceiling of some sort of accord between Democratic leadership in the House, public consent and the White House people. Clearly, there is a movement toward this type of thing, and it is generally applauded in the country, although the specifics of what is involved in that are unknown, and when known, may be very controversial. This is just to say that in the event that we come up with another summit conference, with the suggestion that's pending by the Federal Government should be less than what was contemplated at the early stages of the fiscal 1983 budget year, the odds of movement in terms of this pipeline diminish. What sort of arguments or what sort of substitutions, if we are capped off in terms of the HUD budget or the whole housing picture by some basically bipartisan, bicameral ceiling, what are we to do? What sort of judgments would you make at that point, aside from the thought that this is very sad, and that it should not have been that kind of a world, but those, I think, are the kinds of decisions we might need to make within the next month or so, when we come to the markup.

Mr. **Weiner**. Can I call your attention to two beautifully written paragraphs to the letter I saw recently written to the President of the United States?

Senator **Lugar**. You could, if you want to.

Mr. Weiner. You have answered, in a sense, in these two paragraphs, the essence of the problem. No. 1, you pointed out in that letter that there were serious concerns that have been expressed to you about the contractual commitments that have been made by HUD and the representations. That is the pipeline.

You try to get from HUD some definitely clear expression of what that is and perhaps, Senator, you will find out that problems we have dealing with HUD from a worm's eye view, trying to get some processing through to get some definitive answers from our side of the aisle.

So that I cannot really tell you, and I do not who can, what is the pipeline.

We saw in the budget announcement in February the fact that there is, as of 1981, some 3.4 million—actually 3.75, I believe they said, units in the United States that are getting some kind of a subsidy currently. They said they wanted to put——

Ms. Dolbeare. That's HUD.

Mr. Weiner. They said there was currently outstanding some 700,000 units in the pipeline that had not been occupied and were not authorized.

They then developed some new language—and I always like to learn new words. They said we are now going through a process deobligation.

Diablo, in my language, was the devil. When they talked about deobligation, I got petrified. But deobligation theory was that there are 300,000 units in the pipeline that somehow or other can be just canceled or something done with them. They have done a number of administrative things that have helped to do that.

Now, does this mean there are only 400,000 units left in the pipeline?

They then said that this is the limit that they wanted to set, at 3.8 million, from the 3.4 that they had, so that the 400,000 units were to be used in order to reach their total cap in 1985 or 1986, or whatever the year was.

We are very confused as to what they mean.

If there are 700,000 units in the pipeline and you deobligate 300,000, you still have 400,000 to go. How can you talk about any vouchers or anything else in the next 3 or 4 years in the housing program when you have already set your cap at 3.8?

I must add to my confusion on that subject.

Finally, with regard to the financial thing, I think you pointed it out beautifully, you're going to create the jobs, you're going to get the construction worker and a hell of a lot of guys off workmen's compensation and back to work, and they're going to start paying taxes. We're going to get lumber materials moving, we will get the Oregon industry going again. We will get the guys in Indiana and throughout the country at least into a point where the ripple effect will have, we hope, on the revenue side, a positive effect.

We honestly believe—and I think you have seen some of the economic figures—that this stimulation, in a budgetary sense, if we are looking at it in a budgetary sense, will take care of itself.

This puts aside the argument of whether or not the Government should be subsidizing low- and moderate-income housing. I think that is a separate question.

That is why we have placed the kind of emphasis we have on the pipeline. We think it is good economics, we think it is good housing for the American people.

Senator **Lugar**. Ms. Dolbeare, I assume you agree with that.

Ms. **Dolbeare**. I agree with a great deal of it, yes.

As a matter of fact, I would like to approach this from a slightly different standpoint. First of all, we are not unaware of what is going on, and we are trying to make the case for low-income housing in those quarters as well as here.

I think it is critical to remember that the largest cut made in any single program last year came from low-income housing. This year 37 percent of the total cuts that were proposed by the administration are to come from budget authority for low-income housing. That is measured from the current services level.

Now, that is a bigger cut than the combined total of all of the other cuts in education, training, employment, social services, medicare and medicaid, food stamps, welfare, and the other income security, safety net programs.

I think it is legitimate, once the broad outline of that compromise comes forward, to make sure that the people to make that compromise look not just at the macro framework, which I think is where they are focusing, but also at the impact within programs. So that I would say that we do need to address that.

Building the pipeline, as I understand it, is outside of the framework of that, in any event, because those are commitments already made, that are already reflected in the budget and outlay projects. So, it may well be that the only thing we can do in housing is build the pipeline.

I would argue that as long as we are talking in a framework of very tight constraints, where we are saying that we are not going to produce any additional units, we are not only going to deobligate 300,000 to get down to the 3.8 million ceiling, we are going to deobligate some hundreds of thousands of others in order to make room for the vouchers. I think we would say that is the wrong approach.

Let's build all of the units that are currently obligated, even if it means that we cannot do anything more beyond that, other than keep the present inventory viable. I hate to say that.

Mr. **Edson**. The short answer is that we have already given at the office; we have done our part. No other program has been totaled like section 8, and we are not asking for it back.

Mr. **Weiner**. I am, and she is, too.

Ms. **Dolbeare**. We are.

Mr. **Edson**. We would, too, if we weren't in a real world.

Senator **Lugar**. Nobody has denied the commitment to the overall goal.

You have been most helpful with the practical problems that we've faced. We are deeply indebted to you for coming this morning and for your testimony.

Mr. **Ross**. Thank you.

Mr. **Weiner**. Thank you.

Ms. **Dolbeare**. Thank you.

Senator **Lugar**. The hearing is adjourned.

[Whereupon, at 1:16 p.m., the hearing was adjourned.]

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